Federal Assistance: Grants and Cooperative Agreements

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A. Introduction

The federal government provides assistance in many forms, financial and otherwise. Assistance programs are designed to serve a variety of purposes. Objectives may include fostering some element of national policy, stimulating private sector involvement, or furnishing aid of a type or to a class of beneficiaries the private market cannot or is unwilling to otherwise accommodate. A broad definition of "assistance" in this context is found in 31 U.S.C. § 6101(3) (Federal Program Information Act)— "the transfer of anything of value for a public purpose of support or stimulation authorized by [law]." A similar definition occurs in 31 U.S.C. § 6501(1) (Intergovernmental Cooperation Act of 1968).

A federal grant maybe defined as a form of assistance authorized by statute in which a federal agency (the grantor) transfers something of value to a party (the grantee) usually, but not always, outside of the federal government, for a purpose, undertaking, or activity of the grantee which the government has chosen to assist, to be carried out without substantial involvement on the part of the federal government. The "thing of value" is usually money, but may, depending on the program legislation, also include property or services.[1] The grantee, again depending on the program legislation, may be a state or local government, a nonprofit organization, or a private individual or business entity. Programs administered by state governments comprise the largest category, involving federal outlays of over $100 billion a year.[2]

The 1990 edition (24th cd.) of the Catalog of Federal Domestic Assistance, updated as of December 1990,[3] lists 1,183 assistance programs administered by 52 federal agencies. To be sure, a large number of these are not grant programs since the catalog includes loan and loan guarantee programs plus certain types of non-financial assistance. Nevertheless, it is a safe statement that there are hundreds

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[1]The earliest grant programs were land grants. Monetary grants appear to have entered the stage in 1879 although they are largely a 20th century development. Madden, The Constitutional and Legal Foundations of Federal *Grants, in* Federal Grant Law 9 (M. Mason ed. 1982).

[2]HR Rep No. 696, 101st Cong., 2d Sess. 5 (1990) (report "the House Committee" Government Operations on the Cash Management Improvement Act of 1990). For a summary listing of federal assistance programs for state and local governments, cross-referenced to the Catalog of Federal Domestic Assistance, see Federal Aid: Programs Available to State and Local Governments, GAO/HRD-91-93FS (May 1991).

[3]The Catalog of Federal Domestic Assistance is published annually by the General Services Administration and the Office of Management and Budget pursuant to 31 U.S.C. § 6104 and OMB Circular No. A-89.

of federal grant programs administered by dozens of agencies. Many of the programs are governed by detailed legislation and even more detailed regulations, and many of the cases, since they hinge on specific statutory or regulatory provisions, are not amenable to treatment in this chapter. Nevertheless, it is still possible to extract a number of principles of "grant law" from the perspective of the availability and use of appropriated funds.

B. Grants vs. Procurement Contracts

1. Nature of a Grant

From the perspective of legal analysis, what precisely is a grant? Not too long ago, it was commonplace to discuss the grant relationship in contract terms with little further analysis. Under this approach, the acceptance of a grant of federal funds subject to conditions which must be met by the grantee creates a contract between the United States and the grantee. The need to clearly distinguish grants from procurement contracts, however, has given rise to an emerging body of opinion which attempts to reject the analogy.[4] Thus far, although the contract analogy has not been abandoned, the courts have become increasingly cautious in their characterizations, and elements of both approaches will be found, depending on the precise issue involved.

The "grant as a type of contract" approach evolved from early Supreme Court decisions. In what maybe the earliest case on the issue, the government had made a-t of land to a state on the condition that the state would use the land, or the proceeds from its sale, for certain reclamation purposes. The Court stated:

"It is not doubted that the grant by the United States to the State upon conditions, and the acceptance of the grant by the State, constituted a contract. AU the elements of a contract met in the transaction,--competent parties, proper subject-matter, sufficient consideration, and consent of minds."

[4] E.g., Federal Grant Law (M. Mason ed. 1982) at 2. For further discussion, see P. Dembling & M. Mason, Essentials of Grant Law Practice, Chapter 1 (1991].

McGee v. Mathis, 71 U.S. (4 Wall.) 143, 155 (1866). See also United States v. Northern Pacific Railway Co., 256 U.S. 51,63-64 (1921).

Lower courts applied the contract theory in various contexts, often to enforce grantee compliance with grant conditions,[5] to determine jurisdiction under the Tucker Act,[6] or to analyze the nature of the government's obligations under a particular grant statute or agreement.[7]

GAO followed suit. E.g., 68 Comp. Gen. 609 (1989); 50 Comp. Gen. 470 (1970); 42 Comp. Gen. 289,294 (1962); 41 Comp. Gen. 134, 137 (1961); B-232010, March 23, 1989; B-167790, January 15, 1973. In 50 Comp. Gen. 470, for example, a medical teaching facility, recipient of a reimbursement-type construction grant under the Public Health Service Act, was caught in a cash flow crisis because disbursement of grant funds was much less frequent than its contractor's need for progress payments. The question was whether the grant could be regarded as a "contract or claim" so the recipient could assign future grant proceeds to a bank in return for an interim loan, pursuant to the Assignment of Claims Act. Noting that the accepted grant constituted a "valid contract," and that assignment was not prohibited by the program legislation, regulations of the grantor agency, or the terms of the grant agreement, GAO concluded that assignment under the Assignment of Claims Act was permissible.

Thus, the researcher will find a body of case law standing for the proposition that there are certain contractual aspects to a grant relationship. What this does is provide a known body of law which, together with the relevant program legislation and regulations, is

[5]E.g., United States v. Frazer, 297 F. Supp. 319, 322–23 (M.D. Ala. 1968); United States v. Sumter County School Dist. No. 2,232 F. Supp. 945,950 (E. D.S.C. 1964); United States v. County School Bd., 221 F. Supp. 93, 99–100 (E.D. Va. 1963).

[6]E.g., Missouri Health and Medical Org., Inc. v. United States, 641 F.2d 870 (Ct. Cl. 1981); Texas v. United States, 537 F.2d 466 (Ct. Cl. 1976); County of Suffolk v. United States, 19 Cl. Ct. 295 (1990); Kentucky ex rel. Cabinet for Human Resources v. United States, 16 Cl. Ct. 755, 762 (1989); Rogers v. United States, 14 Cl. Ct. 39,44 (1987); Idaho Migrant Council, Inc. v. United States, 9 Cl. Ct. 85, 88–89 (1985). While most of these cases, Missouri Health for example, use language carefully crafted to avoid confusion between a grant agreement and a "traditional," i.e., procurement, contract, the essence of the jurisdictional finding is that the claim is based on some form of "contract."

[7]E.g., City of Manassas Park v. United States, 633 F.2d 181 (Ct. Cl. 1980), cert. denied, 449 U.S. 1035 (claim found to be noncontractual, but agreement referred to as "grant contract" and grantor-grantee relationship as "privity of contract"); Arizona v. United States, 494 F.2d 1285 (Ct. Cl. 1974).

available to be applied in determining basic rights and obligations. It does not have to follow, nor has GAO or, to our knowledge, any court suggested, that all of the trappings of a procurement contract somehow attach.

The problem, perhaps, is not so much whether a grant relationship can or cannot be said to contain certain "contractual" elements, but in failing to recognize that the analogy is a limited one. Clearly, proponents of the "grant contract" theory must tread cautiously to avoid untenable positions. As we will see in our discussion of the Federal Grant and Cooperative Agreement Act, going too far with the analogy bred confusion which led the Commission on Government Procurement to recommend, and the Congress to enact, legislation to attempt to distinguish between the two types of relationship.

Where all of this will go will be determined in future litigation. For now, in any event, it must be emphasized that whatever one's views on the contractual nature of a grant relationship, a grant and a procurement contract are two very different things.

Take, for example, the issue of consideration. While the typical grant agreement may well include sufficient legal consideration from the standpoint of supporting a legal obligation, it maybe quite different from the consideration found in procurement contracts. As we noted in our introduction to this chapter, a grant is a form of assistance to a designated class of recipients authorized by statute to meet recognized needs. Grant needs, by definition, are not needs for goods or services required by the federal government itself. The needs are those of a nonfederal entity, whether public or private, which the Congress has decided to assist as being in the public interest.

An illustration of where this distinction can lead is 41 Comp. Gen. 134 (1961). A provision of the Federal Water Pollution Control Act authorized grants to states for the construction of sewage treatment works, up to a stated percentage of estimated costs, with the grantee to pay all remaining costs. Strong demand for limited funds meant that grants were frequently awarded for amounts less than the permissible ceiling. The question was whether these grants could be amended in a subsequent fiscal year to increase the amount to, or at least closer to, the statutory ceiling. If a straight "grant equals contract" approach had been applied, the answer would have been no, unless the government received additional consideration. However,

GAO concluded that the amendments were authorized, noting that the "consideration" flowing to the government under these grants-in sharp contrast with procurement contracts-consisted only of 'the benefits to accrue to the public and the United States" through use of the funds to construct the desired facilities. Id. at 137.

In recognition of the essential distinctions between a "grant contract" and a "procurement contract," the Supreme Court has stated:

> "Although we agree. . . that. . . grant agreements had a contractual aspect, . . . the program cannot be viewed in the same manner as a bilateral contract governing a discrete transaction. . . . Unlike normal contractual undertakings, federal grant programs originate in and remain governed by statutory provisions expressing the judgment of Congress concerning desirable public policy."[8]

Bennett v. Kentucky Department of Education, 470 U.S. 656,669 (1985). The state in that case had argued that, since the grant was "in the nature of a contract,"[9] the Court should apply the principle, drawn from contract law, that ambiguities in the grant agreement should be resolved against the government as the drafting party. Based on the analysis summarized in the quoted passage, the Court declined to do so, at least in that case.

Similarly, the contractual doctrine of "impossibility of performance" has been held inapplicable to a grant. Maryland Department of Human Resources v. Department of Health and Human Services, 762 F.2d 406 (4th Cir. 1985). In that case, the government had imposed a zero error standard on states under the Aid to Families with Dependent Children program. The state argued that error-free administration was impossible. While agreeing with that factual proposition, the court nevertheless held that the zero tolerance level was permissible under the governing statute and regulations. The impossibility of performance doctrine "relates to commercial contracts and not to grant in aid programs." Id. at 409.

[8]This passage is a good illustration of the difficulties one can encounter trying to resolve the "grant vs. contract" debate, at least pending further evolution of the case law. On the basis of this passage, which side does the Supreme Court now support? Seth to some extent, it would seem.

[9]Bennett v New Jersey, 470 U.S. 632, 638 (1985), quoting Pennhurst State School and Hosp. v. Halderman, 451 U.S. 1,17 (1981).

A 1971 decision, 51 Comp. Gen. 162, illustrates another distinction. In that case, the Comptroller General concluded that an ineligible grantee could not be reimbursed for expenditures under quantum meruit principles. In the typical grant situation, the grantee's activities are not performed solely for the direct benefit of the government and the government does not receive any measurable, tangible benefit in the traditional contract sense.

Still another distinction is the reluctance of the courts to apply the "contract implied in fact" concept in the grant context. E.g., Somerville Technical Services v. United States, 640 F.2d 1276 (Ct. Cl. 1981). The reasoning in part is that a grant is a sovereign act binding the government only to the extent of its express undertakings.

In American Hospital Association v. Schweiker, 721 F.2d 170 (7th Cir. 1983), cert. denied, 466 US. 958, the court rejected the contention that otherwise valid regulations of the Department of Health and Human Services impaired contractual rights of grantees under the Hill-Burton hospital assistance program.

"[T]he relationship between the government and the hospitals here cannot be wholly captured by the term 'contract' and the analysis traditionally associated with that term. . . . The contract analogy thus has only limited application."

Id. at 182–83. Finally, the court in United States v. Kensington Hospital, 760 F. Supp. 1120 (E.D. Pa. 1991), refused to apply the Anti-Kickback Act to government claims for fraud under the Medicare and Medicaid programs, finding that the government's relationship with its grantees under these programs could not be characterized as "prime contracts" for purposes of the Act.

In sum, it seems clear that many of the rules and principles of contract law will not be automatically applied to grants. Nevertheless, whether one prefers to regard a grant as a type of contract, or "in the nature of" a contract, or as a generically different creature, it is equally clear that the creation of a grant relationship results in certain legal obligations flowing in both directions, enforceable by the application of basic contract rules. As the Claims Court has stated:

"[A] notice of a federal grant award in return for the grantee's performance of services can create cognizable obligations to the extent of the government's undertakings therein."

Community Relations-Social Development Commission v. United States, 8 Cl. Ct. 723, 725 (1985). Thus, if a grantee does what it has committed itself to do and incurs allowable costs, the government is obligated to pay. E.g., B-181332, December 28, 1976.

Conversely, the government has a right to expect that the grantee will use the grant funds only for authorized grant purposes and only in accordance with the terms and conditions of the grant. 42 Comp. Gen. 289,294 (1962); 41 Comp. Gen. 134, 137 (1961). The right of a grantor agency to oversee the expenditure of funds by the grantee to ensure that the money is used only for authorized purposes, and the grantee's corresponding duty to account to the grantor for its use of the funds, are implicit in the grant relationship and are not dependent upon specific language in the authorizing legislation. 64 Comp. Gen. 582 (1985).

2. The Federal Grant and Cooperative Agreement Act

Along-standing confusion between grant relationships and procurement relationships led the Commission on Government Procurement, in its 1972 report, to recommend the enactment of legislation to distinguish assistance from procurement, and to further refine the concept of assistance by clearly distinguishing grants from cooperative agreements.[10] While Congress did not enact all of the Commission's recommendations in this area, it did enact these two, in the form of the Federal Grant and Cooperative Agreement Act of 1977,31 U.S.C. §§ 6301–6308.

Prior to the enactment of this statute, most relationships between the federal government and organizations that received direct federal assistance funding were characterized simply as "grants" or "grants-in-aid."[11] As is still the case, it had always been understood that an agency could make grants only if it was authorized by statute to do so. Prior to the Act, however, it was generally felt that the

[10] Report of the Commission on Government Procurement, Volume 3, Chapters 1-3 generally (December 1972).

[11] Although the terms are often used interchangeably, there is a technical distinction. A "grant-in-aid" is a grant to a state or local government. The term "grant" is broader and includes nongovernmental recipients. See GAO, A Glossary of Terms Used in the Federal Budget Process, PAD-81-27 (March 1981), at 61-62. The Federal Grant and Cooperative Agreement Act was intended to eliminate the term "grant-in-aid" in favor of the simpler "grant," regardless of the identity of the recipient. S. Rep. No. 449, 95th Cong., 2d Sess. 9 (1977), reprinted in 1978 U.S. Code Cong. & Admin. News 11, 18.

legislation pretty much had to mention "grants" explicitly in order to confer that authority.

The Act established standards that agencies are to use in selecting the most appropriate funding vehicle—a procurement contract, a grant, or a cooperative agreement. The standards are contained in sections 4,5, and 6 of the Act, 31 U.S.C. §§ 6303–6305, summarized below:

- Procurement contracts An agency is to use a procurement contract when "the principal purpose of the instrument is to acquire (by purchase, lease, or barter) property or services for the direct benefit or use of the United States Government." 31 U.S.C. $6303.
- Grant agreements. An agency is to use a grant agreement when "the principal purpose of the relationship is to transfer a thing of value [money, property, services, etc.] to the. . . recipient to carry out a public purpose of support or stimulation authorized by a law of the United States instead of acquiring (by purchase, lease, or barter) property or services for the direct benefit or use of the United States Government," and "substantial involvement is not expected" between the agency and the recipient when carrying out the contemplated activity. 31 U.S.C. $6304.
- Cooperative agreements. An agency is to use a cooperative agreement when "the principal purpose of the relationship is to transfer a thing of value to the. . . recipient to carry out a public purpose of support or stimulation authorized by a law of the United States instead of acquiring (by purchase, lease, or barter) property or services for the direct benefit or use of the United States Government," and "substantial involvement is expected" between the agency and the recipient when carrying out the contemplated activity. 31 U.S.C. 56305.

Under the Act, grants and cooperative agreements are more closely related to one another than either is to a procurement contract. The essential distinction between a grant and a cooperative agreement is the degree of federal involvement.

Each agency's program authority must be analyzed to identify the type of relationships authorized, and the circumstances under which each authorized relationship can be entered into without regard to the presence of specific words such as "grant" in the program legislation. Once authority is found, the legal instrument (contract, grant, or cooperative agreement) that fits the arrangement as contemplated

must be used, using the statutory definitions for guidance as to which instrument is appropriate. The Office of Management and Budget is authorized to provide guidance on the implementation of the Act. 31 U.S.C. $6307. OMB published "final guidance" on August 18, 1978 (43 Fed. Reg. 36860).

It is important to note that the Federal Grant and Cooperative Agreement Act does not expand an agency's substantive authority. While the Act provides the basis for examining whether an arrangement should be a contract, grant, or cooperative agreement, determinations of whether an agency has authority to enter into the relationship as spelled out in the instrument, whatever its label, must be based on the agency's authorizing or program legislation, not the Federal Grant and Cooperative Agreement Act. Unless legislatively prohibited, every agency has inherent authority to enter into contracts to procure goods or services for its own use, as long as the purpose of the procurement is reasonably related to the agency's mission. However, there is no comparable inherent authority to give away the government's money or property, either directly or by the release of vested rights, to benefit someone other than the government; this must be authorized by Congress. E.g., 51 Comp. Gen. 162, 165 (1971). Therefore, the agency's basic legislation must be studied to determine whether an assistance relationship is authorized at all, and if so, under what circumstances and conditions.

Where an agency has authority to enter into both a procurement and an assistance relationship to carry out the particular program, it has authority to exercise discretion in choosing which relationship to form in each particular case, but must use the instrument which suits the relationship, as provided in the Act. In this sense, the analysis of an agency's program authority is not really a matter of discretion-the statutory authority either is there or is not there, regardless of agency preference. The significance of the Federal Grant and Cooperative Agreement Act is that it emphasizes the substance of an agency's program authority rather than the particular labels used or not used.

In this connection, the Senate Committee on Governmental Affairs has stated:

"[The Federal Grant and Cooperative Agreement Act] was never intended to be an independent grant of authority to agencies to enter into assistance or contractual relationships where no such authority can be found in authorizing legislation. Rather, it was and is intended to force agencies to use a legal instrument that, according to

the criteria established by the Act, matches the intended and authorized relationship-regardless of the terminology used in existing legislation to characterize the instrument to be used in the transaction."[12]

Further discussion may be found in B-196872-O.M., March 12,1980 and a GAO report entitled Agencies Need Better Guidance for Choosing Among Contracts, Grants, and Cooperative Agreements, GGD-81-88, September 4, 1981.[13]

The approach used in the Federal Grant and Cooperative Agreement Act is illustrated in several decisions. In one case, the Interior Department asked whether it could use its appropriation for expenses of the American Samoan Judiciary for certain expenses, including entertainment and the purchase of motor vehicles. Using the guidelines of the Federal Grant and Cooperative Agreement Act, the Comptroller General reviewed the relationship between the Interior Department and the American Samoan Judiciary and concluded that it was essentially a grant relationship. (Congress confirmed this interpretation by inserting the word "grant" in the next year's appropriation.) Therefore, restrictions such as those relating to entertainent and motor vehicles, which would apply to the direct expenditure of appropriations by the federal government or through a contractor did not apply to expenditures by the grant recipient, absent some provision to the contrary in the appropriation, agency regulations, or grant agreement. B-196690, March 14, 1980.

In 59 Comp. Gen. 424 (1980), the Environmental Protection Agency's public participation program of providing financial assistance to certain interveners was viewed as essentially a grant relationship rather than a contractual one. Accordingly, 31 U.S.C. § 3324 was held not to preclude participants from receiving funds in advance of the completion of participation, subject to the provision of adequate fiscal controls.

[12]S. Rep. No. 180, 97th Cong., 1st Sess. 4 (1981), reprinted in 1982 U.S. Code Cong. & Admin. News 3,6. While this is not direct legislative history with respect to the 1977 statute, it is nevertheless important as a clear statement from one of the relevant jurisdictional committees.

[13]Controversy over whether the Federal Grant and Cooperative Agreement Act constituted an independent source of authority stemmed from an ambiguous provision in the original enactment. See Pub. L. No. 95-224, § 7(a), 92 Stat. 5. When the statute was moved to Title 31 as part of the 1982 recodification of that title, section 7(a) was omitted as duplicative. Thus, while the proposition discussed in the text remains valid, many of the authorities cite to a provision which is no longer found in the U.S. Code.

In several more recent cases, GAO's analysis of the relationship and of relevant legislation and legislative history led it to conclude that a contract, rather than a grantor cooperative agreement, was the proper instrument. 67 Comp. Gen. 13 (1987), affirmed upon reconsideration, B-227084.6, December 19, 1988 (operation of research and training programs at government facility funded by Maritime Administration); 65 Comp. Gen. 605 (1986) (proposed study, sponsored by Council on Environmental Quality, of risks and benefits of certain pesticides, intended for use by federal regulatory agencies); B-222665, July 2, 1986 (awards to Indian tribes by Interior Department under Indian Self-Determination and Education Assistance Act, which contained an express exemption from the Federal Grant and Cooperative Agreement Act); B-210655, April 14, 1983 (funding by Department of Energy of college campus forums on nuclear energy). In 61 Comp. Gen. 428 (1982), however, GAO agreed with the Department of Energy's use of a cooperative agreement to design and construct a "prototype solar parabolic dish/sterling engine system module," finding that the proposal's primary purpose was to encourage development and early market entry rather than to acquire the particular item for its own use, although it would eventually have governmental applications.

These questions are important because procurement contracts are subject to a variety of statutory and regulatory requirements which may not be generally applicable to assistance transactions. If the type of relationship is not determined properly, assistance arrangements could be used to evade otherwise applicable legal requirements. Conversely, legitimate assistance awards should not be burdened by all of the formalities of procurement contracts.

The analysis required by the Federal Grant and Cooperative Agreement Act may also be relevant in determining the applicability of other laws. See, e.g., Hammond v. Donovan, 538 F. Supp. 1106 (W.D. Mo. 1982) holding that the relationship between the Labor Department and a state employment office was a grant, and therefore not subject to a statute which required that certain procurement contracts contain an affirmative action for veterans provision.

Another situation that has generated some controversy is the so-called "third party" or "intermediary" situation-where a federal agency provides assistance to specified recipients by using an intermediary. Again, it is necessary to examine the agency's program authority to

determine the authorized forms of assistance. The agency's relationship with the intermediary should normally be a procurement contract if the intermediary is not itself a member of a class eligible to receive assistance from the government. In other words, if an agency program contemplates provision of technical advice or services to a specified group of recipients, the agency may provide the advice or services itself or hire an intermediary to do it for the agency. In that case, the proper vehicle to fund the intermediary is a procurement contract. The agency is "buying" the services of the intermediary for its own purposes, to relieve the agency of the need to provide the advice or services with its own staff.

On the other hand, if the program purpose contemplates support to certain types of intermediaries to provide consultation or other specified services to third parties, GAO has approved the agency's choice of a grant rather than a contract as the preferred funding vehicle. Thus, in 58 Comp. Gen. 785 (1979), GAO found that the Department of Commerce's Office of Minority Business Enterprise (now the Minority Business Development Agency) could properly award a noncompetitive grant to an intermediary organization to provide management and technical assistance to minority business fins. Although the point was not detailed in the decision, the agency clearly had the requisite program authority to provide grant assistance to the intermediary.

Sometimes the program legislation is much less clear about the status of an intermediary as a grantee. GAO, applied 58 Comp. Gen. 785 in another 1979 case, B-194229, September 20, 1979, upholding the Department of Health, Education, and Welfare's authority to provide grant assistance to an intermediary to in turn provide technical assistance to public schools. There, however, it was doubtful that HEW had the requisite program authority to deal with the intermediary by grant rather than procurement contract. The decision appears to have interpreted the Federal Grant and Cooperative Agreement Act as independently enlarging HEW's program authority.

While GAO has not explicitly stated that B-194229 was wrongly decided, subsequent items, starting with GAO's analysis in GGD-81-88 and B-196872 -O. M., previously cited, have cast considerable doubt on that decision's validity. In a 1982 decision, 61 Comp. Gen. 637, the Department of Housing and Urban Development awarded a cooperative agreement to a nonprofit organization to provide

technical assistance to certain block grant recipients. While HUD's authority to provide technical assistance to the block grant recipients was clear, there was no authority to provide assistance to the intermediary organization. The essence of the intermediary transaction was the acquisition of services for ultimate delivery to authorized recipients. Thus, GAO concluded that a procurement contract should have been used. The decision largely repudiated (although it did not expressly overrule) B-194229. 61 Comp. Gen. at 641.

The Senate Committee on Governmental Affairs, in its 1981 report mentioned earlier in this discussion, also addressed the intermediary issue and agreed with GAO's interpretation:

"The choice of instrument for an intermediary relationship depends solely on the principal federal purpose in the relationship with the intermediary. The fact that the product or service produced by the intermediary may benefit another party is irrelevant. What is important is whether the federal government's principal purpose is to acquire the intermediary's services, which may happen to take the form of producing a product or carrying out a service that is then delivered to an assistance recipient, or if the government's principal purpose is to assist the intermediary to do the same thing. Where the recipient of an award is not receiving assistance from the federal agency but is merely used to provide a service to another entity which is eligible for assistance, the proper instrument is a procurement contract."

S. Rep. No. 180 at 3; 1982 U.S. Code Cong. & Admin. News at 5.

Most of the cases discussed in the remainder of this chapter are expressed in "grant" terms. However, the principles discussed in the cases should generally apply to cooperative agreements as well.

3. Competition for Discretionary Grant Awards

Grant programs are either mandatory or discretionary. In a mandatory grant program, Congress directs awards to one or more classes of prospective recipients who meet specific criteria for eligibility, in specified amounts. These grants, sometimes called "entitlement" grants, are often awarded on the basis of statutory formulas. While the grantor agency may disagree on the application of the formula, it has no basis to refuse to make the award altogether. City of Los Angeles v. Coleman, 397 F. Supp. 547 (D.D.C. 1975). Thus, questions of grantee selection, and hence of competition, do not arise. The concept of competition can only apply when the grantor has discretion to choose one applicant over another. Therefore, the following discussion is limited to discretionary grants.

The Federal Grant and Cooperative Agreement Act encourages competition in assistance programs where appropriate, in order to identify and fund the best possible projects to achieve program objectives. 31 U.S.C. § 6301(3). This, however, is merely a statement of purpose, and there are few other legislative pronouncements specifying how this objective is to be achieved, certainly nothing approaching the detail and specificity of the legislation applicable to procurement contracts, such as the Competition in Contracting Act of 1984. Statutory requirements for competition in grantee selection do exist in certain contexts, but they tend to be very general and do not specify actual procedures. Examples are 10 U.S.C. § 2361(a) (competitive procedures required for Defense Department research grants), and 10 U.S.C. § 2196(i) (ditto for Defense Department manufacturing engineering education grants).

At the request of the Senate Committee on Governmental Affairs, the General Accounting Office surveyed the administrators of 355 discretionary grant programs listed in the Catalog of Federal Domestic Assistance, and studied the award processes for 26 of those programs, to determine the extent of competition. The 355 programs represented about 98,000 awards in fiscal year 1984 to state and local governments and other organizations and individuals, amounting to about $12 billion. GAO found that nearly 2/3 of the programs attempted to solicit applications from all eligible applicants; public interest groups expressed overall satisfaction with agency solicitation practices. Over 3/4 of the programs consistently used persons outside the program office to provide an independent perspective in reviewing applications. Nevertheless, GAO did note some departures from the competitive process which did not appear to have been subjected to internal review and justification. GAO recommended that the President's Council on Management Improvement (established by Executive Order No. 12479, May 24, 1984) work with the agencies in a governmentwide effort to improve managerial accountability for discretionary grant programs. GAO's report is Discretionary Grants-Opportunities to Improve Federal Discretionary Award Practices, GAO/HRD-86-108 (September 1986).

In view of the essential differences between grants and procurement contracts, GAO has declined to use its bid protest mechanism, prescribed to assure the fairness of awards of contracts, to rule on the propriety of individual grant awards–that is, GAO will not consider a complaint by a rejected applicant that it should have received the

grant rather than the recipient to whom it was actually awarded. B-203096, May 20, 1981; B-199247, August 21, 1980; B-199147, June 24, 1980; B-190092, September 22, 1977. This does not affect the Comptroller General's jurisdiction to render decisions on the legality of federal expenditures, however, so GAO can and will render decisions on the legality of grant awards in terms of compliance with applicable statutes and regulations.

GAO has adopted a similar position with respect to cooperative agreements. GAO will not consider a "protest" against the award of a cooperative agreement unless it appears that a conflict of interest exists or that the agency is using the cooperative agreement to avoid the competitive requirements of the procurement laws (i.e., in violation of the Federal Grant and Cooperative Agreement Act) and regulations. 64 Comp. Gen. 669 (1985); 61 Comp. Gen. 428 (1982); B-216587, October 22, 1984. Again, this refers to review under GAO's "bid protest" jurisdiction and does not affect review under GAO's other available authorities.

In summary, assuming the proper instrument has been selected, GAO will not question funding decisions in discretionary federal assistance programs. B-228675, August 31, 1987 (denial of application for funding renewal held to be a policy matter within grantor agency's discretion where nothing in program legislation provided otherwise and agency had complied with applicable procedural requirements). See also City of Sarasota v. Environmental Protection Agency, 813 F.2d 1106 (11th Cir. 1987) (court declined jurisdiction overissue which it characterized as a grant funding decision); Massachusetts Department of Correction v. Law Enforcement Assistance Administration, 605 F.2d 21 (1st Cir. 1979) (court upheld agency's refusal to award grant, finding that procedural deficiencies, even though they amounted to "sloppiness," were not sufficiently grave as to deprive applicant of fair consideration).

The law in this area is still developing in terms of the kinds of issues the courts will look at and the standards and remedies they will apply. Trends and case law are discussed in detail in Richard B. Cappalli, Federal Grants and Cooperative Agreements-Law, Policy, and Practice, Chapter 3 (1982). Cappalli sees an emerging "right to fair process" at least to the extent of requiring agencies to follow applicable procedures (id. at § 3:26), although its precise scope and parameters await further legislative or judicial definition.

C. Some Basic Concepts

1. General Rules

A number of principles have evolved that are unique to grant law. These will be discussed in subsequent sections of this chapter. Many cases, however, involve the application of principles of law which are not unique to grants. As a general proposition, the fundamental principles of appropriations law discussed in preceding chapters apply to grants just as they apply to other expenditures. This section is designed to highlight a few of these areas, each of which is covered in detail elsewhere in this publication, and to show how they may apply in assistance contexts.

a. Statutory Construction

Established principles of statutory construction apply equally to grant legislation. Examples are: 49 Comp. Gen. 411 (1970) (resolution of conflicting elements of legislative history); 49 Comp. Gen. 104 (1969) (principle that meaning should be given to every word in a statute used to construe language in disaster relief assistance legislation); 46 Comp. Gen. 699 (1967) (use of legislative history to clarify reapportionment of unused funds under a formula grant program); B-133001, January 30, 1979 (construing the term "unexpected urgent need" in the Migration and Refugee Assistance Act).

Sometimes they may not apply equally. Under traditional thinking, statutes were viewed as applying prospectively only, unless retroactive application was indicated by the statutory language or legislative history. In most contexts, grant law followed this approach. See, e.g., 32 Comp. Gen. 141 (1952); 30 Comp. Gen. 86 (1950). There were occasional exceptions. For example, in 50 Comp. Gen. 750 (1971), GAO held that an amendment to a program statute which eased certain restrictions could be applied retroactively with respect to funds previously awarded but not yet obligated by the grantees. In 1974, the Supreme Court ruled that a court should "apply the law in effect at the time it renders its decision, unless doing so would result in manifest injustice or there is statutory direction or legislative history to the contrary." Bradley v. Richmond School Board, 416 U.S. 696,711 (1974). Post-Bradley litigation has produced a fairly complex pattern of analysis and, as discussed in Chapter 2, the precise scope of Bradley is unsettled. In any event, the Supreme Court

has declined to apply the Bradley presumption to grant law. In a 1985 decision, the Court held:

"[A]bsent a clear indication to the contrary in the relevant statutes or legislative history, changes in the substantive standards governing federal grant programs do not alter obligations and liabilities arising under earlier grants."

Bennett v. New Jersey, 470 U.S. 632,641 (1985). Thus, for purposes of grant law, "obligations generally should be determined by reference to the law in effect when the grants were made." Id. at 638.

b. The Grant as an Exercise of Congressional Spending Power

when Congress enacts grant legislation and provides appropriations to fund the grants, it is exercising the spending power conferred upon it by the Constitution.[14] As such, it is clear that Congress has the power to attach terms and conditions to the availability or receipt of grant funds, either in the grant legislation itself or in a separate enactment. Oklahoma v. Civil Service Coremission, 330 U.S. 127 (1947) (provision of Hatch Act prohibiting political activity by employees of state or local government agencies receiving federal grant funds upheld as within congressional power).

In Fullilove v. Klutznick, 448 U.S. 448 (1980), the Court upheld a provision of the Public Works Employment Act of 1977 imposing minority set-aside requirements on purchases by state and local grantees. The Court said:

"Congress has frequently employed the Spending Power to further broad policy objectives by conditioning receipt of federal moneys upon compliance by the recipient with federal statutory and administrative directives. This Court has repeatedly upheld against constitutional challenge the use of this technique to induce governments and private parties to cooperate voluntarily with federal policy."

Id. at 474. See also Pennhurst State School and Hospital v. Halderman, 451 U.S. 1, 15–17 (1981); King v. Smith, 392 U.S. 309, 333 n.34 (1968). It follows that, under the Supremacy Clause, valid federal legislation will prevail over inconsistent state law. Townsend v. Swank, 404 U.S. 282 (1971) (state statute inconsistent with

[14] It may be acting under other enumerated powers as well. "Congress is not required to identify the precise source of its authority when it enacts legislation." Nevada v. Skinner, 884 F.2d 445, 449 n.8 (9th Cir. 1989), cert. denied, 493 U.S. 1070.

eligibility criteria of Aid to Families with Dependent Children legislation held invalid).[15]

More recently, the Supreme Court has reaffirmed the power of Congress to attach conditions to grant funds, provided that the conditions are (1) in pursuit of the general welfare, (2) expressed unambiguously, (3) reasonably related to the purpose of the expenditure, and (4) not in violation of other constitutional provisions. New York v. United States, ___ U.S. _, 112 S. Ct. 2408, 2426 (1992); South Dakota v. Dole, 483 U.S. 203, 207–08 (1987). Dole upheld legislation directing the Department of Transportation to withhold a percentage of federal highway funds from states which do not adopt a minimum drinking age of 21. Similarly, legislation conditioning the receipt of federal highway funds on state adoption of the national speed limit has been upheld. Nevada v. Skinner, 884 F.2d 445 (9th Cir. 1989), cert. denied, 493 U.S. 1070.

Where Congress has imposed an otherwise valid condition on the receipt of grant funds by states, the condition is, in effect, a "condition precedent" to a state's participation in the program. Unless permitted under the program legislation, the condition may not be waived or omitted even though a given state may not be able to participate because state law or the state constitution precludes compliance. North Carolina ex rel. Morrow v. Califano, 445 F. Supp. 532 (E. D.N.C. 1977), aff'd mem., 435 U.S. 962; 43 Comp. Gen. 174 (1963).

Of course, it is also within the power of Congress to authorize the making of unconditional grants. See B-80351, September 30, 1948.

c. Availability of Appropriations

As with obligations and expenditures in general, a federal agency may provide financial assistance only to the extent authorized by law and available appropriations. Thus, the three elements of legal availability—purpose, time, and amount-apply equally to assistance funds.

[15]It has also been recognized that the regulations of a grantor agency, if otherwise valid, may preempt state law. S.J. Groves& Sons v. Fulton County, 920 F.2d 752, 763–64 (11th Cir. 1991).

(1) Purpose

Appropriations may be used only for the purpose(s) for which they were made. 31 U.S.C. § 1301(a). One of the ways in which this fundamental proposition manifests itself in the grant context is the principle that grant funds may be obligated and expended only for authorized grant purposes. What is an 'authorized grant purpose" is determined by examining the relevant program legislation, legislative history, and appropriation acts.

Disaster relief assistance legislation, found at 42 U.S.C. Chapter 68, authorizes, among other things, federal financial contributions to state and local governments for the repair or replacement of public facilities damaged by a major disaster. Decisions under a prior version of this legislation had construed public facilities as including municipal airports (42 Comp. Gen. 6 (1962)), including airport facilities which had been leased to private parties for the purpose of generating income for airport maintenance (49 Comp. Gen. 104 (1969)). Assistance could also extend to a sewage treatment plant, but not one which was not completed, and thus not in operation, at the time of the damage. 45 Comp. Gen. 409 (1966). Unlike the earlier legislation, the current statute defines "public facility," 42 U.S.C. § 5122(8), and specifically includes airport and sewage treatment facilities. Some other examples are:

- Airport development grants under Federal Airport Act may include runway sealing projects which are shown to be part of reconstruction or repair rather than normal maintenance. 35 Comp. Gen. 588 (1956). See also B-60032, September 9,1946 (grants under same legislation may be made for acquisition of land or existing privately owned airports, to be used as public airports, regardless of whether construction or repair work is immediately contemplated).
- Mining Enforcement and Safety Administration is authorized to make grants to a labor union to fund emergency medical technician training program for coal miners since the proposal bears a sufficiently close relationship to coal mine safety to come within the scope of the governing program legislation. B-170686, November 8, 1977.
- Public Health Service grants for support of research training were found authorized under the Public Health Service Act. B-161769, June 30, 1967.

A grant for unspecified purposes would, unless expressly authorized by Congress, be improper. 55 Comp. Gen. 1059, 1062 (1976).

A case from the 7th Circuit Court of Appeals illustrates the proposition that an agency may reallocate discretionary funds within a lump-sum appropriation as long as it uses those funds for other authorized purposes of the appropriation and does not violate the applicable program legislation. Under the Clean Air Act, the Environmental Protection Agency may prescribe plans to implement air quality standards for states which fail to submit adequate plans. The Act also authorizes air pollution control grants to states, funded under EPA's lump-sum Abatement, Control, and Compliance appropriation. Under its regulations, EPA divides available funds into nonmandatory annual allotments for each state. The regulations also authorize EPA to set aside a portion of the unawarded allotments to support federal implementation programs where required because of the absence of adequate state programs. One state argued that the set-aside policy amounted to a diversion of funds from their intended purpose and therefore violated 31 U.S.C. § 1301(a). The court first upheld the regulation as a permissible interpretation of EPA's authority under the Clean Air Act. The court then found that there was no purpose violation because (a) the relevant appropriation act did not earmark any specific amount for grants to states, and (b) EPA was still using the set-aside funds for air pollution abatement programs, which was their intended purpose. Illinois Environmental Protection Agency v. United States EPA, 947 F.2d 283 (7th Cir. 1991).

This is essentially the same reasoning the Comptroller General had applied in B-157356, August 17, 1978. The (then) Department of Health, Education, and Welfare received a lump-sum appropriation for its Office of Human Development Services covering a number of grant programs. The Department wanted to make what it termed "cross-cutting" grants to fund research or demonstration projects which would benefit more than one target population (e.g., aged, children, Native Americans). To do this, each office receiving grant funds under the lump-sum appropriation was asked to set aside a portion of its grant funds. This pool would then be used for approved cross-cutting grants. Since the lump-sum appropriation did not restrict the Department's internal allocation of funds for any given program, GAO approved the concept, provided that the grants were limited to projects within the scope or purpose of the appropriation, a condition necessary to assure compliance with 31 U.S.C. § 1301(a).

(2) Time

Funds must be obligated by the grantor agency within their period of obligational availability. This includes all actions necessary to constitute a valid obligation. For example, an "offer of grant" made by the Economic Development Administration to a Connecticut municipality in 1983 was accepted by a town official who did not have authority to accept the grant; and the funds expired for obligational purposes before the town was able to ratify the unauthorized acceptance. Under these circumstances, GAO concluded that a valid grant never came into existence. B-220527, December 16, 1985. The town later submitted a claim for reimbursement of its expenses, based on an "equitable estoppel" argument. Since the non-existence of the grant was attributable to the town's actions and not those of the EDA, the claim could not be allowed, B-220527, August 11, 1987. See also B-206244, June 8, 1982.

The" bona fide needs" rule applies to grants and cooperative agreements just as it applies to other types of obligations or expenditures. 64 Comp. Gen. 359 (1985); B-229873, November 29, 1988. In 64 Comp. Gen. 359, obligation of fiscal year appropriations for 3-year biomedical research grants was found improper where not authorized by statute and where the grants did not contemplate a required outcome or end product.

(3) Amount

Restrictions on the availability of a lump-sum appropriation are not legally binding unless incorporated expressly or by reference in the appropriation act itself. Thus, a plan to fund National Institutes of Health biomedical research grants, funded under a lump-sum appropriation, in a number less than that specified in committee reports was not unlawful, as long as all funds were properly obligated for authorized grant purposes. 64 Comp. Gen. 359 (1985). See also B-157356, August 17, 1978.

Minimum earmarks (e.g., "not less than" or "shall be available only") in an authorization act were found controlling where a later-enacted appropriation act provided a lump sum considerably less than the amount authorized but nevertheless sufficient to meet the earmark requirements. 64 Comp. Gen. 388 (1985). The grantor agency will have more discretion where the earmark is a maximum ("not to

exceed"), or where it is expressed only in legislative history. B-171019, March 2, 1977.

Similar rules apply to expenditures by grantees. In the absence of an earmark or other controlling provision in the applicable program statute, regulations, or the grant agreement, there is no basis to object to a grantee's allocation of grant funds as long as the funds were spent for eligible grant activities. 69 Comp. Gen. 600 (1990).

The concept of augmentation of appropriations also applies to assistance funds. One illustration is the rule that a federal institution is generally not eligible to receive grant funds from another federal institution unless the program legislation expressly so provides. The reason is that the grant funds would improperly augment the appropriations of the receiving institution. For example:

- Federal grant funds for nurse training programs could not be allotted to St. Elizabeth Hospital since it was already receiving appropriations to maintain and operate its nursing school. 23 Comp. Gen. 694 (1944).
- Haskell Indian Junior College, fully funded by the Bureau of Indian Affairs, was not eligible to receive grant funds from federal agencies other than the Bureau of Indian Affairs, since Congress had already provided for its needs by direct appropriations. B-114868, April 11, 1975,
- The Office of Education could not make a library support grant under the Higher Education Act of 1965 to the National Commission on Libraries and Information Science as it would bean improper augmentation of the Commission's appropriations. 57 Comp. Gen. 662,664 (1978).

The appropriations which would be augmented by the grant do not have to be specific appropriations for the prohibition to apply. B-69616, November 19, 1947. Of course, Congress may legislatively authorize exceptions. E.g., B-217093, January 9, 1985.

d. Agency Regulations

(1) General principles

Legislation establishing an assistance program frequently will define the program objectives and leave it to the administering agency to fill in the details by regulation. Thus, agency regulations are of paramount importance in assessing the parameters of grant authority.

These regulations, if properly promulgated and within the bounds of the agency's statutory authority, have the force and effect of law and may not be waived on a retroactive or ad hoc basis. 57 Comp. Gen. 662 (1978) (eligibility standards); B-163922, February 10, 1978 (grantee's liability for improper expenditures); B-130515, July 17, 1974; B-130515, July 20, 1973 (matching share requirements). However, the prohibition against waiver does not necessarily apply to regulations which are merely "internal administrative guidelines" as long as the government's interests are adequately protected. See 60 Comp. Gen. 208,210 (1981).

The operation of several of these principles is illustrated in B-203452, December 31, 1981. The Federal Aviation Administration revised its regulations to permit indirect costs to be charged to Airport Development Aid Program grants. A grantee filed a claim for reimbursement of indirect costs incurred prior to the change in the FAA regulations, arguing that the charging of indirect costs was required by a Federal Management Circular even before FAA recognized it in its own regulations. GAO first pointed out that Federal Management Circulars are internal management tools. They do not have the binding effect of law so as to permit a third party to assert them against a non-complying agency. This being the case, there was no impediment to FAA's revising its regulations without making the revision retroactive, as long as both the old and the new regulations were within the scope of FAA's legal authority. See also Pueblo Neighborhood Health Centers, Inc. v. Department of Health and Human Services, 720 F.2d 622, 625–26 (10th Cir. 1983) (HHS Grant Application Manual was an internal agency publication rather than a regulation with force and effect of law, such that deviation by agency–in this case use of an ineligible member on a funding review panel-did not require reversal of agency action).

Regulations of the grantor agency will generally be upheld, even if they are not specifically addressed in the program legislation, as long as they are within the agency's statutory authority, issued in compliance with applicable procedural requirements, and not arbitrary or capricious. For example, courts have upheld the authority of the Department of Agriculture to impose by regulation strict liability on states for lost or stolen food stamp coupons. Gallegos v. Lyng, 891 F.2d 788 (10th Cir. 1989); Louisiana. Bergland, 531 F. Supp. 118 (M.D. La. 1982), aff'd sub nom. Louisiana. Block, 694 F.2d 430 (5th Cir. 1982); Hettleman v. Bergland, 642 F.2d 63 (4th

Cir. 1981). Similarly, it was within the discretion of the Environmental Protection Agency under the Clean Water Act to prescribe regulations making wastewater treatment grants available only for the construction of new facilities and not for the acquisition of preexisting facilities. Cole County Regional Sewer District v. United States, 22 Cl. Ct. 551 (1991). "The EPA, like all government agencies, is subject to funding constraints and must effectuate policy objectives with available resources. " Id. at 557. Another illustration is American Hospital Association v. Schweiker, 721 F.2d 170 (7th Cir. 1983), cert. denied, 466 U.S. 958, upholding regulations imposing community service and uncompensated care requirements on recipients of Hill-Burton hospital construction grants.

Wholly apart from what the courts might or might not do, an agency's discretion in funding matters is subject to congressional oversight as well. Congress, if it disfavors an agency's actual or proposed exercise of otherwise legitimate discretion, can statutorily restrict that discretion, at least prospectively, either by amending the program legislation or by inserting the desired restrictions in appropriation acts. For an example of the latter, see B-238997.4, December 12, 1990.

The informal rulemaking requirements (notice and comment) of the Administrative Procedure Act do not apply to grant regulations. 5 U.S.C. § 553(a)(2). Several agencies, however, have published statements committing themselves to compliance with the APA and have thereby effectively waived the exemption. Where regulations are required to be published in the Federal Register, failure to do so may render them ineffective. The issue has been before the courts on several occasions. See, e.g., B-130515, July 17, 1974. (See Chapter 3 for further elaboration and case citations.)

A case not cited in Chapter 3 which applies several important Administrative Procedure Act principles in the grant context is Abbs v. Sullivan, 756 F. Supp. 1172 (W.D. Wis. 1990). A grantee university and one of its professors challenged a set of scientific misconduct investigation guidelines which the National Institutes of Health had published in a grants administration manual but not in the Federal Register. The court first found that the guidelines met the APA's definition of a 'rule." Id. at 1187. The court then noted that the Department of Health and Human Services had voluntarily waived the exemption in 5 U.S.C. § 553 for rules relating to grants, and was

thereby bound to follow the notice and comment procedures of the APA. Id. at 1188. The court also rejected the government's contention that the guidelines were "procedural" and therefore exempt. "Although an agency's label is relevant, it is not dispositive of the true character of the agency statement." Id. Accordingly, the court held the guidelines "invalid unless and until they are promulgated in compliance with the procedures required by the APA." Id. at 1189.

(2) The "common rules"

The importance of agency regulations and management guidance from the Office of Management and Budget is apparent throughout this chapter. Since the structure of that material changed drastically in the late 1980s, a summary of the new structure maybe helpful.

For a number of years, uniform administrative requirements from OMB have been contained in two key circulars, A-102 (assistance to state, local, and Indian tribal governments) and A-1 10 (institutions of higher education, hospitals, and other nonprofit organizations). The structure of each circular was similar-a brief introduction followed by more than a dozen attachments with detailed guidance on specific topics.

In 1987, a memorandum from the President directed OMB to revise Circular A-102 to specify uniform, governmentwide terms and conditions for grants to state and local governments, and directed executive branch departments and agencies to propose and issue common regulations adopting these terms and conditions verbatim, modified where necessary to reflect inconsistent statutory requirements. 23 Weekly Comp. Pres. Dec. 254 (March 12, 1987).

A proposed common rule was published on June 9, 1987 (52 Fed. Reg. 21819), and the final common rule was published on March 11, 1988 (53 Fed. Reg. 8033), generally effective as of October 1, 1988. The rule was adopted by over 20 agencies, including all of the major grantor agencies. The title is identical for each agency: Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments. The revised Circular A-102 was issued on March 3, 1988. It is much simplified from its predecessor, much of the detail having been shifted to the individual agency regulations.

Under the common rule, the pertinent Code of Federal Regulations title and part number will, of course, vary with the agency. Section numbers, however, are identical for each agency. For example, the definition section is ___.3 and the provision dealing with program income is ___.25.

The common rule itself is published at 53 Fed. Reg. 8087–8103. Pages 8042–8087 give the preambles and variations of the adopting agencies. References to the common rule in this chapter will cite the rule itself and not the regulations of any particular agency. The reader is therefore cautioned to check individual agency regulations for possible variations,

The common rule is intended to supersede unmodified manuals and handbooks unless required by statute or approved by the Office of Management and Budget. Common Rule §___ .5,53 Fed. Reg. 8090. With respect to grants and grantees covered by the common rule, additional administrative requirements are to be in the form of codified regulations published in the Federal Register. Id. §___.6(a).

In addition to the A-102 implementation, the "common rule" format has been used in several other grant-related contexts.

On February 18, 1986, as part of the government's effort to combat fraud, waste, and abuse, the President signed Executive Order No. 12549, which directed the establishment of a system for debarment and suspension in the assistance context. OMB implemented the executive order by publishing a common rule, this one entitled "Governmentwide Debarment and Suspension (Nonprocurement)," adopted by over 25 grantor agencies and patterned generally on comparable provisions for procurement contracts in the Federal Acquisition Regulation. 53 Fed. Reg. 19160 (May 26, 1988). A person (including business entities and units of government) who is debarred is excluded from federal assistance and benefits, financial and nonfinancial, under federal programs and activities for a period of up to three years, possibly longer. Common Rule §§___.100(a) (purpose), ___.105(n) (definition of person), _.320 (period of debarment), 53 Fed. Reg. at 19204-05, 19208. Causes of debarment are listed in §___.305,53 Fed. Reg. at 19207. They include certain criminal convictions, antitrust violations, a history of unsatisfactory performance, and failure to pay a single substantial debtor a number of outstanding debts owed to the federal government.

Suspension is a temporary exclusion, usually pending the completion of an investigation involving one or more of the causes for debarment. See generally Common Rule Subpart D, 53 Fed. Reg. 19208–09.

The General Services Administration is responsible for compiling and distributing a list of debarred or suspended persons. Id. §___.500,53 Fed. Reg. 19209. The list, entitled Lists of Parties Excluded from Federal Procurement or Nonprocurement Programs, is issued monthly by GSA's Office of Acquisition Policy and is also available electronically.

Another common rule, in the form of an "interim final rule" adopted by 28 grantor agencies, was issued on February 26, 1990 (55 Fed. Reg. 6736) to implement restrictions on grantee lobbying enacted in late 1989 and described in our section on lobbying in Chapter 4.

Still another common rule was issued on May 25, 1990 (55 Fed. Reg. 21681) to implement the Drug-Free Workplace Act of 1988 (41 U.S.C. § 702), which requires that grant recipients, including individuals, certify as a precondition of receiving federal funds that they have taken certain anti-drug abuse measures. Violation of the statute or regulations may result in suspension of grant payments, suspension or termination of the grant, and/or suspension or debarment of the grantee for a period of up to 5 years. 41 U.S.C. § 702(b); Common Rule §___.620,55 Fed. Reg. at 21689.

2. Contracting by Grantees

Grantees commonly enter into contracts with third parties in the course of performing their grants. While the United States is not a party to the contracts, the grantee must nevertheless comply with any requirements imposed by statute, regulation, or the terms of the grant agreement, in awarding federally assisted contracts. 54 Comp. Gen. 6 (1974). Violation of applicable procurement standards may result in the loss of federal funding. E.g., Town of Fallsburg v. United States, 22 Cl. Ct. 633 (1991).

For a period of nearly 10 years, GAO undertook a limited review of the propriety of contract awards made by a grantee in furtherance of grant purposes, upon request of a prospective contractor. This limited review role was announced in 40 Fed. Reg. 42406 (September 12, 1975). (GAO called these "complaints" rather than "protests.") GAO

applied the same limited review to contracts awarded under cooperative agreements. 59 Comp. Gen. 758 (1980).

GAO's review was designed primarily to ensure that the "basic principles" of competitive bidding were applied. 55 Comp. Gen. 390, 393 (1975). Numerous decisions were rendered in this area. E.g., 57 Comp. Gen. 85 (1977) (non-applicability of Buy American Act); 55 Comp. Gen. 1254 (1976) (state law applicable when indicated in grant); 55 Comp. Gen. 413 (1975) (non-applicability of Federal Procurement Regulations).

By 1985, many agencies had developed their own review procedures, and the number of complaints filed with GAO steadily decreased. Determining that its review of grantee contracting was no longer needed, GAO discontinued its limited review in January 1985.50 Fed. Reg. 3978 (January 29, 1985); 64 Comp. Gen. 243 (1985). The body of decisions issued during the 1975–1985 period should nevertheless remain useful as guidance in this area.

In a 1980 report, GAO reviewed the procurement procedures of selected state and local government grantees and nonprofit organizations in five states. The report concluded that the state and local governments generally had and followed sound procurement procedures (somewhat less so for the nonprofit), but also found a number of weak spots, many of which are now addressed in OMB directives. The report is Spending Grant Funds More Efficiently Could Save Millions, PSAD-80-58 (June 30, 1980).

With respect to state and local governments, standards for grantee procurement are set forth in §___.36 of the Common Rule, 53 Fed. Reg. 8096. Grantor agencies are authorized, but not required, to establish formal review procedures for grantee procurements. See id. §§___.36(b)(11), (12); Supplementary Information Statement, 53 Fed. Reg. 8034,8039 (March 11, 1988).

An agency which establishes a review procedure for grantee procurement will be held to established precepts of administrative law in applying those procedures. For example, in Niro Atomizer, Inc. v. Environmental Protection Agency, 682 F. Supp. 1212 (S.D. Fla. 1988), the court instructed EPA to either follow its established procedures or announce that it was changing them, giving the parties notice and an opportunity to rebut.

3. Liability for Acts of Grantees

It is often said that the federal government is not liable for the unauthorized acts of its agents, "agents" in this context referring to the government's own officers and employees. If this is true with respect to those who clearly are agents of the government, it logically must apply with even greater force with respect to those who are not its agents. Grantees, for purposes of imposing legal liability on the United States, are not "agents" of the government. While the demarcation is not perfect, we divide our discussion into two broad areas, contractual liability and tortious conduct.

a. Contractual Liability to Third Parties

In order for the United States to be contractually liable to some other party, there must be "privity of contract," that is, a direct contractual relationship, between the parties. When a grantee under a federal grant enters into a contract with a third party (contractor), there is privity between the United States and the grantee, and privity between the grantee and the contractor, but no privity between the United States and the contractor and hence, as a general proposition, no liability.

Perhaps the leading case in this area is D.R. Smalley& Sons, Inc. v. United States, 372 F.2d 505 (Ct. Cl. 1967), cert. denied, 389 U.S. 835. The plaintiff contractor had entered into a highway construction contract with the state of Ohio. The project was funded on a cost-sharing basis, with 90 percent of total costs to come from federal-aid highway funds. The contractor lost nearly $3 million on the project, recovered part of its loss from the state of Ohio, and then sued the United States to recover the unpaid balance. The contractor argued that Ohio was really the agent of the United States for purposes of the project because, among other things, the contract had been drafted pursuant to federal regulations, the United States approved the contract and all changes, and the United States was funding 90 percent of the costs.

The court disagreed. Since there was no privity of contract between the United States and the contractor, the government was not liable. The involvement of the government in various aspects of the project did not make the state the agent of the federal government for purposes of creating contractual liability, express or implied. The court stated:

"The National Government makes many hundreds of grants each year to the various states, to municipalities, to schools and colleges and to other public organizations and

agencies for many kinds of public works, including roads and highways. It requires the projects to be completed in accordance with certain standards before the proceeds of the grant will be paid. Otherwise the will of Congress would be thwarted and taxpayers' money would be wasted. . . . It would be farfetched indeed to impose liability on the Government for the acts and omissions of the parties who contract to build the projects, simply because it requires the work to meet certain standards and upon approval thereof reimburses the public agency for a part of the costs."

Id. at 507. Some later cases applying the Smalley concept are Somerville Technical Services v. United States, 640 F.2d 1276 (Ct. Cl. 1981); Housing Corporation of America v. United States, 468 F.2d 922 (Ct. Cl. 1972); Cofan Associates, Inc. v. United States, 4 Cl. Ct. 85 (1983); 68 Comp. Gen. 494 (1989).

The Cofan case presented an interesting variation in that the claimant was a disappointed bidder rather than a contractor, trying to recover under the theory, well-established in the law of procurement contracts, that there is an implied promise on the part of the government to fairly consider all bids. This did not help the plaintiff, however, since again there was no privity with the government.

"[I]t is now firmly established that a person who enters into a contract with a [grantee] to perform services on a project funded in part by loans or grants-in-aid from the United States may not thereby be deemed to have entered into a contract with the United States. Nor is the result any different because the United States has imposed guidelines or restrictions on the use of the funds, including procurement procedures." 4 CL Ct. at 86.

Another variation occurred in 47 Comp. Gen. 756 (1968). A contractor had succeeded in recovering increased costs from a state grantee. Under Smalley, it was clear that the government could not be held legally liable for a proportionate share of the recovery. However, it was apparent that the increased costs were due to the fact that erroneous soil profile information furnished by the state had contributed to an unrealistically low bid by the contractor. Under these circumstances, GAO advised that the grantor agency and the state could enter into a voluntary modification of the grant agreement to recognize the damage recovery as a project cost. See also B-167310, July 31, 1969.

In limited circumstances, there is a device that may be available to a contractor to have its claim considered by the federal government, illustrated by B-181332, December 28, 1976. In that case, an agency had erroneously refused to fund a grant after it had been approved

and the grantee's contractor had incurred expenses in reliance on the approval. There clearly was no privity between the contractor and the United States. However, GAO recognized a procedural device drawn from the law of procurement contracts, and accepted a claim filed by the grantee (with whom the United States did have privity) "for and on behalf of" the contractor, in which the grantee acknowledged liability to the contractor only if and to the extent that the government was liable to the grantee. In effect, the contractor was prosecuting the claim in the name of the grantee. This device is potentially useful only where the government's liability to the grantee can be established. See also 68 Comp. Gen. 494, 495–96 (1989); 9 Comp. Gen. 175 (1929).

A different type of contract, an employment contract, was the subject of 66 Comp. Gen. 604 (1987), in which GAO concluded, applying Smalley, that the United States was not liable to a former employee of a grantee for unpaid salary, The grantor agency had funded all allowable costs under the grant, and the grantee's transgression was not the liability of the United States,

As if to prove the adage that anything that can happen will happen, a 1983 case combined all of the elements noted above. The Agency for International Development made a rural development planning grant to Bolivia. Bolivia contracted with a private American company to perform certain functions under the grant, and the company in turn entered into employment contracts with various individuals. The contract with the private company (but not the grant itself) was terminated, the company terminated the employment contracts, and the individuals then sought to recover benefits provided under Bolivian law. Clearly, AID was not legally liable to the individual claimants. However, some of the benefits to some of the claimants could qualify as allowable costs under the grant and could be paid, if approved by AID and the grantee, to the extent grant funds remained available. B-209649, December 23, 1983.

b. Tortious Conduct

A number of cases have involved attempts to impose liability on the United States under the Federal Tort Claims Act or similar situations. The Federal Tort Claims Act makes the United States liable, with various exceptions, for the tortious conduct of its officers, employees, or agents acting within the scope of their employment. As a general proposition, a grantee is not an agent or agency of the government for purposes of tort liability.

An important Supreme Court case is United States v. Orleans, 425 U.S. 807 (1976), holding that a community action agency funded under the Economic Opportunity Act is not a "federal agency" for purposes of Federal Tort Claims Act. The case arose from a motor vehicle accident involving plaintiff Orleans and an individual acting on behalf of a grantee. The Court first noted that the Federal Tort Claims Act "was never intended, and has not been construed by this Court, to reach employees or agents of all federally funded programs that confer benefits on people." Id. at 813. The Court then stated, and answered, the controlling test:

> "[T]he question here is not whether the [grantee] receives federal money and must comply with federal standards and regulations, but whether its day-to-day operations are supervised by the Federal Government.
>
> . . . .
>
> ". . . The Federal Government in no sense controls 'the detailed physical performance' of all the programs and projects it finances by gifts, grants, contracts, or loans." Id. at 815–16.

Thus, the general rule is that the United States is not liable for torts committed by its grantees. Neither the fact of federal funding nor the degree of federal involvement encountered in the typical grant (approval, oversight, inspection, etc.) is sufficient to make the grantee an agent of the United States for purposes of tort liability. Liability could result, however, if the federal involvement reached the level of detailed supervision of day-to-day operations noted in Orleans. An example is Martarano v. United States, 231 F. Supp. 805 (D. Nev. 1964) (state employee under cooperative agreement working under direct control and supervision of federal agency).

The same rules apply for purposes of determining the liability of the United States for a taking of private property under the Fifth Amendment. E.g., Hendler v. United States, 11 Cl. Ct. 91, 98–99 (1986). For actions which may have taking implications, agencies should also be familiar with the policies and requirements of Executive Order No. 12630, March 15, 1988.

In another group of cases, attempts have been made to find the United States liable under the Federal Tort Claims Act for the allegedly negligent performance of its oversight role under a grant. The courts have found these claims covered by the "discretionary function"

exception to Federal Tort Claims Act liability. Mahler v. United States, 306 F.2d 713 (3d Cir. 1962), cert. denied, 371 U.S. 923, followed in Daniel v. United States, 426 F.2d 281 (5th Cir. 1970), and Rayford v. United States, 410 F. Supp. 1051 (M.D. Term. 1976).

In areas not covered by the Federal Tort Claims Act, such as the so-called constitutional tort, the potential for individual liability cannot be disregarded. For example, an official of the Indian Health Service, acting jointly with a state official, told a nonprofit intermediary that further funding would be conditioned on the dismissal of an employee whom they thought was performing inadequately. The intermediary fired the employee, who then sued the state official and the federal official in their individual capacities. The suit against the federal defendant was based directly on the Fifth Amendment, for deprivation of a property interest (the plaintiff's job) without due process. The court first found that there had been a due process violation, and that the defendants were not entitled to qualified immunity because their conduct exceeded the scope of their authority. Merritt v. Mackey, 827 F.2d 1368 (9th Cir. 1987). The court noted that there was no basis for imposing liability on the United States. Id. at 1373-74. In the second published appellate decision in the case, the court affirmed a monetary damage award and an award of attorney's fees against the individual officials. The federal official was personally liable for the fee award under 42 U.S.C. § 1988 because he had acted in concert with a state official. Merritt v. Mackey, 932 F.2d 1317 (9th Cir. 1991).

Finally, a case deserving brief mention, although not involving the monetary liability of the United States, is Dixson v. United States, 465 US. 482 (1984), in which the Supreme Court held that two officers of a private, nonprofit corporation, who were assigned to administer two federal community development block grants awarded by the Department of Housing and Urban Development to the city of Peoria, were "public officials" who could be prosecuted under the federal bribery statute.

4. Types of Grants: Categorical vs. Block

A categorical grant is a grant to be used only for a specific program or for narrowly defined activities. A categorical grant maybe allocated on the basis of a distribution formula prescribed by statute or regulation ("formula grant"), or it may be made for a specific project ("project grant"). A block grant is a grant given to a governmental

unit, usually a state, to be used for a variety of activities within a broad functional area.[16] Block grants are usually formula grants. Under a block grant, the state is responsible for further distribution of the money. States naturally prefer block grants because they increase the states' spending flexibility and at least in theory reduce federal control.

During the 1960s and 1970s, although some block grant programs were in existence, the emphasis was largely on categorical grants. The Omnibus Budget Reconciliation Act of 1981 (OBRA), Public Law 97-35, attempted to put a halt to this trend. The statute merged and consolidated several dozen categorical grant programs into block grants. The following programs stem from, or were significantly revised by, the 1981 OBRA (the OBRA title and page citation and U.S. Code location are indicated parenthetically for each program):

- Community Development Block Grant (Title III, 95 Stat. 384,42 U.S.C. Ch. 69).
- Elementary and Secondary Education Block Grant (Title V, 95 Stat. 463. The law was overhauled in 1988; the successor version is found at 20 U.S.C. Ch. 47).
- Community Services Block Grant (Title VI, 95 Stat. 511, 42 U.S.C. Ch. 106).
- Preventive Health and Health Services Block Grant (Title IX, 95 Stat. 535,42 U.S.C. Ch. 6A, Subch. XVII, Part A).
- Alcohol and Drug Abuse and Mental Health Services Block Grant (Title IX, 95 Stat. 543,42 U.S.C. Ch. 6A, Subch. XVII, Part B).
- Maternal and Child Health Services Block Grant (Title XXI, 95 Stat. 818,42 U.S.C. Ch. 7, Subch. V).
- Social Services Block Grant (Title XXIII, 95 Stat. 867,42 U.S.C. Ch. 7, Subch. XX).
- Low-Income Home Energy Assistance Block Grant (Title XXVI, 95

[16]GAO, A Glossary of Terms Used in the Federal Budget Process, PAD-81-27, at 61-62 (March 1981).

Stat. 893, 42 U.S.C. Ch. 94, Subch. II).[17]

Block grants do reduce federal involvement in that they transfer much of the decision-making to the grantee and reduce the number of separate grants that must be administered by the federal government. However, it is a misconception to think that block grants are "free money" in the sense of being totally free from federal "strings."

Restrictions on the use of block grant funds may derive from the organic legislation itself. For example, several of the OBRA programs include such items as limitations on allowable administrative expenses, prohibitions on the use of funds to purchase land or construct buildings, "maintenance of effort" provisions, and anti-discrimination provisions. Other OBRA provisions of general applicability (Pub. L. No. 97-35, §§ 1741–1745, 95 Stat. 762–64) impose reporting and auditing requirements, and require states to conduct public hearings as a prerequisite to receiving funds in any fiscal year.

Applicable restrictions are not limited to those contained in the program statute itself. Other federal statutes applicable to the use of grant funds must also be followed. See, e.g., Ely v. Velde, 451 F.2d 1130 (4th Cir. 1971), holding that the National Historic Preservation Act and the National Environmental Policy Act applied to a block grant made by the Law Enforcement Assistance Administration to Virginia under the Safe Streets Act. A later and related decision in the same case is 497 F.2d 252 (4th Cir. 1974). See also Maryland Department of Human Resources v. Department of Health and Human Services, 854 F.2d 40 (4th Cir. 1988) (requirement for apportionment by Office of Management and Budget applicable to funds under Social Services Block Grant); 6 Op. Off. Legal Counsel 605 (1982) (Uniform Relocation Assistance Act applicable to Community Development block grant); 6 Op. Off. Legal Counsel 83 (1982) (various

[17]GAO has issued a number of studies and reports on the OBRA block grants. Some of them are Early Observations on Block Grant Implementation, GAO/GGD-82-79 (August 24, 1982); Lessons Lamed From Past Block Grants: Implications for Congressional Oversight., GAO/IPE-82-8 (September 23, 1982); A Summary and Comparison of the Legislative Provisions of the Block Grants Created by the 1981 Omnibus Budget Reconciliation Act, GAO/IPE-83-2 (December 30, 1982); Block Grants: Overview of Experiences to Date and Emerging Issues, GAO/HRD-85-46 (April 3, 1985); and Community Development: Oversight of Block Grant Needs Improvement, GAO/RCED-91-23 (January 30, 1991). GAO has also published a comprehensive catalog of formula grants, intended for use as a resource document. It is: Grant Formulas: A Catalog of Federal Aid to States and Localities, GAO/HRD-87-28 (March 1987).

anti-discrimination statutes applicable to Elementary and Secondary Education and Social Services block grants).

Thus, the block grant mechanism does not totally remove federal involvement nor does it permit the circumvention of federal laws applicable to the use of grant funds. In this latter respect, a block grant is legally no different from a categorical grant.

The common rule for uniform administrative requirements does not apply to the OBRA block grants. Common Rule §___.4(a), 53 Fed. Reg. 8089.

5. The Single Audit Act

We noted in our Introduction to this chapter that federal grants to state and local governments exceed $100 billion a year. With expenditures of this magnitude, it is essential that there be some way to assure accountability on the part of the grantees. The traditional means of assuring accountability has been the audit.

Prior to 1984, there were no statutory uniform audit requirements for state and local government grantees. Audits were performed on a grant or program basis and requirements varied with the program legislation. Under this system, gaps in audit coverage resulted because some entities were audited infrequently or not at all. Also, overlapping requirements produced duplication and inefficiency with multiple audit teams visiting the same entity and reviewing the same financial records. Congress addressed the problem by enacting the Single Audit Act of 1984, Pub. L. No. 98-502, codified at 31 U.S.C. §§ 7501–7507.[18] An informative discussion of the need for the legislation, with references to several reports by GAO and the Joint Financial Management Improvement Program, may be found in the report of the House Committee on Government Operations, H.R. Rep. No. 708, 98th Cong., 2d Sess., reprinted in 1984 U.S. Code Cong. & Admin. News 3955.

[18] For an early review of the law's implementation, see Single Audit Act: Single Audit Quality Has Improved but Some Implementation Problems Remain, GAO/AFMD-89-72 (July 1989).

As a general proposition, a state or local government which receives at least $100,000 in federal financial assistance[19] in any fiscal year must have an audit, of the type prescribed in the statute, performed for that fiscal year by an independent auditor. The requirement differs if federal financial assistance is less than $100,000.31 U.S.C. §§ 7502(a)(1) and (c). Audits are to be conducted annually. However, biennial audits are permissible if the grantee has, prior to January 1, 1987, so provided in its constitution or statutes. Id. § 7502(b). The audit is to be conducted "in accordance with generally accepted government auditing standards." Id. § 7502(c). These standards are found in GAO's publication Government Auditing Standards (1988), informally known as GAO's "yellow book," The Office of Management and Budget, in consultation with GAO, is required to prescribe "policies, procedures, and guidelines" to implement the Single Audit Act. 31 U.S.C. § 7505(a). These are found in OMB Circular No. A-128, Audits of State and Local Governments (1985).

The audit may be a single comprehensive audit covering the entire state or local government or a series of audits of individual agencies, and may be limited to those agencies which actually received or administered federal financial assistance. 31 U.S.C. §§ 7502(d)(1), (d)(6).

The audit required by the Single Audit Act is essentially a financial and compliance audit and does not include "economy and efficiency audits, program results audits, or program evaluations." Id. § 7502(c) .20 The statute prescribes the major components of the audit:

- Determinations that the grantee's financial statements fairly present its financial position and the results of its financial operations, and that it has complied with laws and regulations that may materially affect its financial statements.
- Evaluation of the recipient's internal control systems.

[19] While we have framed our discussion in terms Of grants, "federal financial assistance" 'or purposes of the Single Audit Act includes "grants, contracts, loans, loan guarantees, property, cooperative agreements, interest subsidies, insurance, or direct appropriations," but excludes direct federal cash assistance to individuals. 31 U.S.C. § 7501(4).

[20] The different types of government audits are described in GAO'S Government Auditing Standards, Chapter 2.

• Compliance With laws and regulations that may have a material effect upon applicable major federal assistance programs. This includes the testing of a representative number of transactions from each major program. ("Major" programs are determined under criteria specified in 31 U.S.C. § 7501(12).)

31 U.S.C. § 7502(d)(2)–(d)(4); H.R. Rep. No. 708 at 10, reprinted in 1984 U.S. Code Cong. & Admin. News 3964. The state or local government must submit to the appropriate federal officials a plan for corrective action to address any material noncompliance with applicable laws and regulations or material weakness in internal controls uncovered by the audit. 31 U.S.C. § 7502(g).

The "single audit" replaces financial or financial and compliance audits which state or local governments are required to conduct under various program statutes. 31 U.S.C. § 7503(a). Thus, for example, absent a statutory exception to the Single Audit Act, the Environmental Protection Agency is not authorized to require a state to provide a separate financial or financial and compliance audit of its water pollution revolving fund in addition to the "single audit." B-241096, January 30, 1991 (internal memorandum). However, the Act does not limit the authority of any federal agency to conduct additional audits or evaluations authorized by federal law or regulation, including economy/efficiency and program audits. 31 U.S.C. §§ 7503(c), (e).

The cost of a single audit is to be shared by the state or local government and the federal government, generally in the same proportion that federal financial assistance bears to the recipient's total expenditures for the fiscal year(s) covered by the audit. 31 U.S.C. § 7505(b); OMB Circular No. A-128, § 16. The federal government's share, determined under this formula, becomes an allowable cost to the relevant programs. Federal agencies which conduct additional audits or evaluations as authorized by 31 U.S.C. § 7503(c) are responsible for their funding. Id. § 7503(e).

The law also directs the Comptroller General to monitor provisions in bills and resolutions reported by committees of the Senate and House of Representatives that require financial or financial and compliance audits, and to report to appropriate congressional committees any such provisions which are inconsistent with the Single Audit Act. 31 U.S.C. $7506.

As noted above, the Single Audit Act applies only to state and local governments. The need for reliable and comprehensive auditing, however, applies equally to all grantees. In recognition of this, the Office of Management and Budget issued OMB Circular No. A-133, Audits of Institutions of Higher Education and Other Nonprofit Institutions (1990), which establishes auditing requirements for nonprofits similar to those of the Single Audit Act. Regardless of the identity of the grantee, whether a governmental organization or a nonprofit institution, sound auditing practices of the type envisioned by the Single Audit Act and the OMB Circulars are indispensable to assuring the efficient use of audit resources and to improving the financial management of federal assistance programs. See, e.g., GAO report Promoting Democracy: National Endowment for Democracy's Management of Grants Needs Improvement, GAO/NSIAD-91-162 (March 1991).

D. Funds in Hands of Grantee: Status and Application of Appropriation Restrictions

Expenditures by grantees for grant purposes are not subject to all of the same restrictions and limitations imposed on direct expenditures by the federal government. For this reason, grant funds in the hands of a grantee have been said to largely lose their character and identity as federal funds. The Comptroller General has stated the principle as follows:

"It consistently has been held with reference to Federal grant funds that, when such funds are granted to and accepted by the grantee, the expenditure of such funds by the grantee for the purposes and objects for which made [is] not subject to the various restrictions and limitations imposed by Federal statute or our decisions with respect to the expenditure, by Federal departments and establishments, of appropriated moneys in the absence of a condition of the grant specifically providing to the contrary." 43 Comp. Gen. 697,699 (1964).

Thus, except as otherwise provided in the program statute, regulations, or the grant agreement, the expenditure of grant funds by a state government grantee is subject to the applicable laws of that state rather than federal laws applicable to direct expenditures by federal agencies. 16 Comp. Gen. 948 (1937). The rule applies "with equal if not greater force" when the grantee is another sovereign nation. B-80351, September 30, 1948.

This does not mean that an agency can circumvent a statutory restriction by making a grant to do something it could not do directly. What it does mean is that when an agency makes a grant for a valid

grant purpose, the grantee has a measure of discretion in choosing the means to implement the grant, subject to applicable statutes, regulations, and the terms of the grant agreement. In exercising that discretion, restrictions that would apply to direct expenditures by the grantor agency do not necessarily apply to the grantee. Of course, the expenditure must be for an otherwise valid grant purpose and must not be prohibited by the terms of the grant agreement.

One group of cases[21] involves restrictions on employee compensation and related payments. Examples are:

- Provision in Labor-Federal Security Appropriation Act, 1948, prohibiting use of federal funds to pay salaries of persons engaging in a strike against the United States Government, did not apply to funds granted to states to assist in enforcing Fair Labor Standards Act and Walsh-Healey Public Contracts Act. The funds were not "salaries" as such; they were grant funds to reimburse states for services of state employees, and therefore were state rather than federal funds. 28 Comp. Gen. 54 (1948). See also 39 Comp. Gen. 873 (1960).
- Requirement for specific authorizing legislation to use public funds to pay employer contributions for federal employees' health and life insurance benefits does not apply to use of federal grant funds to contribute to state group health and life insurance programs for state employees. 36 Comp. Gen. 221 (1956).
- Restrictions on retired pay not applicable to retired military officer working on grant-funded state project. 14 Comp. Gen. 916 (1935), modified on other grounds by 36 Comp. Gen. 84 (1956).
- Federal restrictions on dual compensation for federal employees are inapplicable to grantee employees. B-153417, February 17, 1964.

The rule has been applied in a variety of other contexts as well. One example is the area of state and local taxes. Thus, federal immunity from payment of certain sales taxes does not apply to a state grantee since the grantee is not a federal agent. The grant funds lose their federal character and become state funds. Therefore, the state grantee may pay a state sales tax on purchases made with federal grant funds if the tax applies equally to purchases made from all nonfederal funds. 37 Comp. Gen. 85 (1957). See also B-177215, November 30, 1972, applying the same reasoning for purchases made by a contractor who

[21] Some of the decisions cited may involve statutory restrictions on federal expenditures which have been changed or repealed since the decisions were issued. The cases are cited solely to illustrate the application of the grant rule and thus remain valid to that extent.

was funded by a federal grantee. Similarly, a state tax on the income of a person paid from federal grant funds involves no question of federal tax immunity. 14 Comp. Gen. 869 (1935).

The following is a sampling of other restrictions which have been found inapplicable to grantee expenditures:

- Adequacy of Appropriations Act (41 U.S.C. § 11) and prohibition on entering into contracts for construction or repair of public buildings, or other public improvements, in excess of amount specifically appropriated for that purpose (41 U.S.C. § 12). B-173589, September 30, 1971.
- Prohibition in 31 U.S.C. § 1343 on purchasing aircraft without specific statutory authority. 43 Comp. Gen. 697 (1964) (permissible for grantee under National Science Foundation research grant). See also B-196690, March 14, 1980 (purchase of motor vehicles). However, an agency may not acquire excess aircraft or passenger vehicles by transfer for use by its grantees. 55 Comp. Gen. 348 (1975).
- Prohibition in 31 U.S.C. § 1345 on payment of nonfederal persons' travel and lodging expenses to attend a meeting. 55 Comp. Gen. 750 (1976).
- Requirement for specific authority in order to establish a revolving fund. (Federal agency would need specific authority in view of 31 U.S.C. § 3302(b)). 44 Comp. Gen. 87 (1964).
- A grantee's entertainment expenses maybe allowable if incurred in furtherance of grant purposes and if not otherwise prohibited by statute, regulation, or the grant agreement. 64 Comp. Gen. 582, 587 (1985); B-196690, March 14, 1980; B-187150, October 14,1976. Having said this, however, it should be the rare occasion when entertainment expenses are in fact allowable, assuming agencies follow the Office of Management and Budget's instructions to treat them as unallowable. (See OMB Circulars A-21, A-87, A-122.)

Where assistance funds are provided to the District of Columbia under a program of assistance to the states which defines "state" as including the District of Columbia, statutory restrictions expressly applicable to the District of Columbia remain applicable with respect to the assistance funds even though they would not necessarily apply to the assistance funds in the hands of the other states. 34 Comp. Gen. 593 (1955); 17 Comp. Gen. 424 (1937); A-90515, December 23, 1937.

When applying the general proposition that grantee expenditures are not subject to the same restrictions as direct federal expenditures, it is important to keep in mind that grantees are obligated upon acceptance of grant funds to spend them for the purposes and objectives of the grant, subject to any statutory or special conditions imposed on the use of assistance funds. See, e.g., 42 Comp. Gen. 682 (1963); 2 Comp. Gen. 684 (1923). These conditions may include implied requirements, such as the implied requirement of the "basic principles" of open and competitive bidding in the case of grantee contracts. 55 Comp. Gen. 390 (1975), They also include statutorily authorized requirements, as in the case of the Office of Personnel Management's authority to establish merit standards for grantees under 42 U.S.C. § 4728(b) (Intergovernmental Personnel Act of 1970). Statutory restrictions on lobbying with public funds may also apply to grantee expenditures.

In addition, several federal statutes prohibit various types of discrimination." Title VI of the Civil Rights Act of 1964 (42 U.S.C. § 2000d) prohibits discrimination on the basis of race, color, or national origin under any program or activity receiving federal financial assistance. The Rehabilitation Act of 1973, as amended in 1978 (29 U.S.C. § 794), similarly prohibits discrimination against handicapped individuals. The Age Discrimination Act of 1975 extends the prohibition to discrimination on the basis of age (42 U.S.C. § 6102).

Title IX of the Education Amendments of 1972 (20 U.S.C. § 1681) prohibits sex discrimination under certain education programs, and Title VII of the Civil Rights Act of 1964 (42 U.S.C. § 2000e-2) would prohibit employment discrimination by grantees on the basis of sex as well as race, color, religion, or national origin. In addition, several block grant statutes contain their own anti-discrimination provisions and include sex discrimination. As of the date of this publication, however, the editors have found no general statutory prohibition against sex discrimination in the awarding of federal assistance funds. (The extent to which the equal protection clause of the Constitution might come into play is a question left to the courts.)

[22]For a detailed Justice Department opinion on the applicability of the major anti-discrimination statutes to federal assistance funds, with particular emphasis on block grants, see 6 Op. Off. Legal Counsel 83 (1982).

Statements in some of the cases to the effect that grant funds upon being paid over to the grantee are no longer federal funds should not be taken out of context. The fact that grant funds in the hands of a grantee are no longer viewed as federal funds for certain purposes does not mean that they lose their character as federal funds for all purposes. It has been held that the government retains a "property interest" in grant funds until they are actually spent by the grantee for authorized purposes. This property interest may take the form of an "equitable lien," stemming from the government's right to ensure that the funds are used only for authorized purposes, or a "reversionary interest" (funds that can no longer be used for grant purposes revert to the government). By virtue of this property interest, the funds-and property purchased with those funds to the extent unrestricted title has not vested in the grantee-are not subject to judicial process without the government's consent. E.g., Henry v. First National Bank of Clarksdale, 595 F.2d 291, 308–09 (5th Cir. 1979), cert. denied, 444 us. 1074.

The concept is illustrated in two cases from the Court of Appeals for the Seventh Circuit. In Palmiter v. Action, Inc., 733 F.2d 1244 (7th Cir. 1984), the court rejected the argument that grant funds lose their federal character when placed in the grantee's bank account, and held that federal grant funds in the hands of a grantee are not subject to garnishment to satisfy a debt of the grantee. The holding would presumably not apply where the grantee had actually spent its own money and the federal funds were paid over as reimbursement. Id. at 1249. More recently, the court considered a similar issue in the context of a bankruptcy petition filed by a grantee under Chapter 7 of the Bankruptcy Code. The issue was whether grant funds in the hands of the grantee, as well as personal property purchased with grant money, were assets of the bankrupt and therefore subject to the control of the trustee in bankruptcy. Directing the trustee to abandon the assets, the court held that they remained the property of the federal government. In the course of reaching this result, the court noted that unpaid creditors of the bankrupt could, to the extent their claims were within the scope of the grant, be paid by the grantor agency out of the recovered funds. In re Joliet-Will County Community Action Agency, 847 F.2d 430 (7th Cir. 1988).

A case discussing both Palmiter and Joliet-Will, and reaching a similar result, is In re Southwest Citizens' Organization for Poverty Elimination, 91 Bankr. 278 (Bankr. D.N.J. 1988). A grantee, which

had purchased a number of motor vehicles with Head Start grant funds, filed a Chapter 11 bankruptcy petition. The Department of Health and Human Services sought turnover of the property, contending that the bankrupt's title was subject to the government's right to require transfer to another grantee under the program legislation and regulations. The trustee argued that the motor vehicles were property of the bankruptcy estate, and that the trustee's interest superseded any interest of the government. After a detailed review of precedent, the court directed turnover of the vehicles, concluding that the government's rights amounted to a reversionary interest.

Another theory occasionally encountered but which appears to have received little in-depth discussion is the trust theory-that a grantee holds grant funds, and property purchased with those funds, in the capacity of a trustee. In Joliet-Will, for example, the court found that the grantee was essentially "a trustee, custodian, or other intermediary, who . . . is merely an agent for the disbursal of funds belonging to another," and that the grantee's "ownership" was nominal, like that of a trustee. 847 F.2d at 432. The trust concept finds support in an early Supreme Court decision, Stearns v. Minnesota, 179 U.S. 223 (1900), a land grant case in which the Court discussed the grant in trust terms. Id. at 243,249. Some agencies have incorporated the trust concept in their program regulations. Examples are cited in B-239907, July 10, 1991 (Economic Development Administration), and United States v. Rowen, 594 F.2d 98, 100 (5th Cir. 1979) (former Department of Health, Education, and Welfare). See also 64 Comp. Gen. 103, 106 (1984).

A final area in which grant funds in the hands of a grantee continue to be treated as federal funds is the application of federal criminal statutes dealing with theft of money or property belonging to the United States. There are numerous cases in which the courts have applied various provisions of the Criminal Code, such as 18 U.S.C. § 641, to the theft or embezzlement of grant funds or grant property in the hands of grantees. Examples involving a variety of grant programs are Hayle v. United States, 815 F.2d 879 (2d Cir. 1987); United States v. Harris, 729 F.2d 441 (7th Cir. 1984); United States v. Hamilton, 726 F.2d 317 (7th Cir. 1984); United States v. Montoya, 716 F.2d 1340 (10th Cir. 1983); United States v. Smith, 596 F.2d 662 (5th Cir. 1979); United States v. Rowen, 594 F.2d 98 (5th Cir. 1979).

In each of these cases, the court rejected the argument that the statute did not apply because the funds or property were no longer federal funds or property. It makes no difference whether the funds are paid to the grantee in advance or by reimbursement (Montoya, 716 F.2d at 1344), or that the funds may have been commingled with nonfederal funds (Hayle, 815 F.2d at 882). The holdings are based on the continuing responsibility of the federal government to oversee the use of the funds. E.g., Hayle, 815 F.2d at 88>; Hamilton, 726 F.2d at 321. The result would presumably be different in the case of grant funds paid over outright with no continuing federal oversight or supervision. E.g., Smith, 596 F.2d at 664.

E. Grant Funding

1. Advances of Grant/Assistance Funds

The statutory prohibition on the advance payment of public funds, 31 U.S.C. $3324, does not apply to grants. Since assistance awards are made to assist authorized recipients and are not primarily for the purpose of obtaining goods or services for the government, the policy behind the advance payment prohibition has much less force in the case of assistance awards than in the case of procurement contracts. Accordingly, it has been held that 31 U.S.C. § 3324 does not preclude advance funding in authorized grant relationships. Unless restricted by the program legislation or the applicable appropriation, the authority to make grants is sufficient to satisfy the requirements of 31 U.S.C. $3324.60 Comp. Gen. 208 (1981); 59 Comp. Gen. 424 (1980); 41 Comp. Gen. 394 (1961). As stated in 60 Comp. Gen. at 209, "[t]he policy of payment upon receipt of goods or services is simply inconsistent with assistance relationships where the Government does not receive anything in the usual sense."

This does not mean that there can never bean advance payment problem in a grant case. Two cases involving violations—56 Comp. Gen. 567 (1977) and B-159715, August 18, 1972—are discussed in Chapter 5. Also, since the authority to advance funds must, at least in a general sense, be founded on the program legislation, advance payments would probably not be authorized under an assistance program that provided for payment by reimbursement.

2. Cash Management Concerns and Requirements

One problem with the advance funding of assistance awards is that the recipient may draw down funds before they are actually needed. This is a matter of concern for several reasons. For one thing, advances under an assistance program are intended to accomplish the program purposes and not to profit the recipient other than in the manner and to the extent specified in the program.

But there is another reason. When money is drawn from the Treasury before it is needed, or in excess of current needs, the government loses the use of the money. The principle was expressed as follows in B-146285, October 2, 1973:

> "When Federal receipts are insufficient to meet expenditures, the difference is obtained through borrowing; when receipts exceed expenditures, outstanding debt can be reduced. Thus, advancing funds to organizations outside the Government before they are needed either unnecessarily increases borrowings or decreases the opportunity to reduce the debt level and thereby increases interest costs to the Federal Government."

Thus, premature drawdown not only profits the recipient, but does so at the expense of the rest of the taxpayers. GAO has made the same point in several reports, such as Improving Medicaid Cash Management Will Reduce Federal Interest Costs, HRD-81-94 (May 29, 1981), and Better Cash Management Cart Reduce the Cost of the National Direct Student Loan Program, FGMSD-80-5 (November 27, 1979).[23]

Congress has recognized these concerns in several ways, one of which was the October 1990 enactment of section 4 of the Cash Management Improvement Act of 1990, Pub. L. No. 101-453, 104 Stat. 1058, 31 U.S.C. $3335. This legislation requires executive agencies to provide for the "timely disbursement" of federal funds in accordance with Treasury Department regulations.

If an agency's failure to comply with Treasury disbursement regulations results in increased cost to the General Fund of the Treasury (for example, increased interest expenses resulting from increased borrowing needs), the Secretary of the Treasury may collect this amount from the offending agency for credit as miscellaneous

[23]This principle is not limited to premature drawdown but applies equally to other types of premature or excess payments. E.g., GAO report entitled Unnecessary Interest Costs Incurred by the Government Because of Excess Progress Payments to Contractors (B-118662, March 22, 1965).

receipts, 31 U.S.C. §§ 3335(b) and (c). The legislative history stresses that this penalty authority is to be "restricted to cases of egregious or repeated noncompliance, and [not to] be used in a routine manner to finance interest costs incurred by the Federal Government." H.R. Rep. No. 696, 101st Cong., 2d Sess. 7 (1990).

If an agency could pay its noncompliance penalty to the Treasury simply by reducing awards under its assistance programs, the penalty would effectively "cost" the agency nothing, the program beneficiaries would suffer, and little would be accomplished. The legislation addresses this by requiring that penalties be paid from administrative rather than program appropriations, "to the maximum extent practicable." 31 U.S.C. § 3335(d); H.R. Rep. No. 696 at 7.

Regulations applicable to all assistance recipients are found in Treasury Department Circular No. 1075 (31 C.F.R. Part 205) and pertinent Office of Management and Budget circulars. The essence of the government's policy is stated in 31 C.F.R. § 205.4(a):

"Cash advances to a recipient organization shall be limited to the minimum amounts needed and shall be timed to be in accord only with the actual, immediate cash requirements of the recipient organization in carrying out the purpose of the approved program or project. The timing and amount of cash advances shall be as close as is administratively feasible to the actual disbursements by the recipient organization for direct program costs and the proportionate share of any allowable indirect costs."

Thus, it is within the discretion of the Social Security Administration to determine that a period of 15 months between drawdown and disbursement for state employee retirement contributions is excessive, and to make an appropriate disallowance. B-244617, December 24, 1991. The requirement to minimize the time elapsing between transfer of funds to the recipient and disbursement by the recipient is also stated in OMB Circulars A-102 (para. 7a) and A-110 (Attachment I, para. 1). It is also reflected in the Common Rule §§ ___.20(b)(7) and ___.21(b), 53 Fed. Reg. 8091.

Until the Cash Management Improvement Act is fully implemented, current Treasury regulations provide that, if annual advances to a grantee total less than $120,000, or there is no continuing grantor-grantee relationship for at least one year, advances are made by direct Treasury check scheduled to make funds available only immediately prior to grantee disbursement. 31 C.F.R. § 205.4(c).

If annual advances aggregate $120,000 or more and the relationship is expected to continue for at least one year, advances are made by "letter of credit." 31 C.F.R. § 205.4(b). A letter of credit is an instrument (Standard Form 1193A) executed by an authorized certifying officer of the grantor agency permitting a grantee to draw funds needed for immediate disbursement. A letter of credit is irrevocable and is the equivalent of cash "to the extent the recipient organization has obligated funds in good faith thereunder in executing the authorized Federal program in accordance with the grant, contract, or other agreement." 31 C.F.R. $205.5. The Treasury Department's letter of credit procedures are found in the Treasury Financial Manual, Vol. I, Part 6, Chapters 2000 and 2500. Disbursements under most letters of credit are made by electronic fund transfer to a financial institution designated by the recipient organization.

If a recipient is unwilling or unable to establish procedures to minimize the gap between drawdown and disbursement, advance funding may be terminated and payments made only on a reimbursement basis. 31 C.F.R. $205.7.

In Maryland Department of Human Resources v. Department of Health and Human Services, 854 F.2d 40 (4th Cir. 1988), the plaintiff state argued that it should receive its entire annual Social Services Block Grant allotment at once at the beginning of the fiscal year. The court disagreed, upholding quarterly apportionment by the Office of Management and Budget under 31 U.S.C. $1512.

3. Interest on Grant Advances

a. In General

The Comptroller General has consistently held that except as otherwise provided bylaw, interest earned by a grantee on funds advanced by the United States under an assistance agreement pending their application to grant purposes, belongs to the United States rather than to the grantee. All such interest is required to be accounted for as funds of the United States, and must be deposited in the Treasury as miscellaneous receipts under 31 U. SC. § 3302(b). 71 Comp. Gem 387 (1992); 69 Comp. Gen. 660 (1990); 42 Comp. Gen. 289 (1962); 40 Comp. Gen. 81 (1960); B-203681, September 27, 1982; B-192459, July 1, 1980; B-149441, April 16, 1976; B-173240,

August 30, 1973. See also Common Rule §___.21(i), 53 Fed. Reg. 8091. If the grantee is unable to document the actual amount of interest earned on the grant advances, the grantor agency should use the "Treasury tax and loan account" rate prescribed by 31 U.S.C. § 3717 for debts owed to the United States. 69 Comp. Gen. 660 (1990).

Except for states, discussed separately later, the rule applies whether the grantee is a public or private agency. The rationale for the rule is that unless expressly provided otherwise, funds are paid out to a grantee to accomplish the grant purposes, not for the grantee to invest the money and earn interest at the expense of the Treasury. Thus, funds paid out to a grantee are not to be held, but are to be applied promptly to the grant purposes. 1 Comp. Gen. 652 (1922).

In 40 Comp. Gen. 81 (1960), the Comptroller General held that interest on foreign currencies advanced by the Department of Agriculture under cooperative agreements, earned between the time the funds were advanced and the time they were used, could not be retained for program purposes but had to be returned to the Treasury for deposit as miscellaneous receipts.

In 42 Comp. Gen. 289 (1962), the rule was applied with respect to State Department grants to American-sponsored schools and libraries overseas. The Comptroller General stated, "[t]here can be no doubt that only the Congress is legally empowered to give away the property or money of the United States." Id. at 293. The decision further concluded that the enabling legislation did not provide sufficient authority to use the grant funds to establish a permanent interest-bearing endowment fund. In B-149441, February 17, 1987, GAO found that since the National Endowment for the Humanities had no authority in its program legislation to permit its grantees to establish an endowment fund with grant moneys, it could not authorize its grantees to accomplish the same purpose with matching funds.

Citing both 42 Comp. Gen. 289 and B-149441, the Comptroller General held in 70 Comp. Gen. 413 (1991) that legislative authority would be required for a proposal whereby the United States Information Agency would purchase discounted foreign debt from commercial lenders and transfer the notes to grantees in the foreign country, who would in turn exchange the notes for local currency or

local currency denominated bonds and use the income for program activities. However, since USIA has statutory authority to accept conditional gifts, it could accept a donation of foreign debt and use the principal and income for authorized activities in accordance with the conditions specified.

Once grant funds are applied by the grantee to the accomplishment of the purpose of the grant, the rule no longer applies. Thus, in B-230735, July 20, 1988, where use of grant funds to establish an endowment trust was authorized bylaw, GAO concluded that the grantee could use income from the endowment as nonfederal matching funds on other grants, as long as such use was consistent with the terms and conditions of the grant agreement.

In B-192459, July 1, 1980, a grantee transferred grant funds to a trustee under a complex construction financing arrangement. The trustee was independent rather than an agent of the grantee and the grantee could not get the funds back upon demand. GAO determined that the transfer to the trustee was in the nature of a disbursement for grant purposes. Therefore, interest earned by the trustee after the transfer could be treated as grant income and retained under the terms of the grant agreement. However, interest on grant funds placed in bank accounts and certificates of deposit by the grantee prior to transfer had to be returned to the Treasury. The grantor agency lacked the authority to permit the grantee to retain interest earned on grant funds prior to their application to grant purposes.

In 64 Comp. Gen. 103 (1984), the Agency for International Development advanced grant funds to the government of Egypt, which in turn advanced them to certain local and provincial elements of that government. Since the purpose of the grant was to assist Egypt in its efforts to decentralize certain governmental functions by developing experience at the local level in managing and financing selected projects, GAO concluded that the advances of funds by the government of Egypt to the local and provincial entities could legitimately be viewed as disbursements for grant purposes. Thus, the subgrantees could retain interest earned on those advances. However, in another 1984 case also involving the Agency for International Development, GAO found that subgrantees could not retain interest on funds advanced to them by the recipient under a cooperative agreement whose purpose was to help develop certain technologies, where the funds had been advanced prior to any legitimate program

need. 64 Comp. Gen. 96 (1984). Both decisions followed the approach set forth in B-192459, summarized above.

In evaluating the disposition of interest income, an important determinant is whether the interest was earned before or after the grant funds were applied to authorized grant purposes. The keyword here is "authorized." For example, under the Community Development Block Grant program, grantees may use the funds to make loans for certain community projects. Grantees may retain interest earned on those loans as a type of "program income." However, if a loan is later found to be ineligible under the program, the funds were never used for an authorized grant purpose, and interest earned by the grantee must be paid over to the United States for deposit as miscellaneous receipts, 71 Comp. Gen. 387 (1992).

Congress can, of course, legislatively make exceptions to the rule, by providing assistance in the form of an unconditional gift or by other appropriate statutory provisions. See, e.g., 44 Comp. Gen. 179 (1964) (provision in appropriation act exempting educational institutions from liability for interest under certain Public Health Service Act grants); B-175155, June 11, 1975 (interest rule not applicable with respect to "grants" to Amtrak); B-202116-O. M., February 12, 1985 (Legal Services Corporation grantees).[24]

b. Grants to State Governments

Prior to 1968, the prohibition on retention of interest income applied to states as well as to other grantees. 20 Comp. Gen. 610 (1941); 3 Comp. Gen. 956 (1924); 26 Comp. Dec. 505 (1919); 24 Comp. Dec. 403 (1918); A-46031, January 16, 1933. There was no reason to draw a distinction. This, of course, was premised on the absence of any statutory guidance.

The treatment of interest on grant advances to state governments is now governed by the so-called Intergovernmental Cooperation Act of 1968 (IGCA), as amended, 31 U.S.C. Chapter 65. The law evolved in two stages. The original IGCA created what was to be, for 22 years, the major exception to the rule that interest on grant advances belongs to the United States. The law first codified the requirement for agencies to schedule the transfer of grant funds so as to minimize

[24] A conceptually related case is 71 Comp. Gen. 310 (1992), upholding a Small Business Administration regulation providing for a reasonable profit to grantees under the Small Business Innovation Development Act.

the time elapsing between transfer and grantee disbursement.[25] It then provided: "A State is not accountable for interest earned on grant money pending its disbursement for program purposes." 31 U.S.C. § 6503(a) (1988).

The theory behind the Intergovernmental Cooperation Act was to control the release of grant funds and thereby preclude situations from arising in which state grantees would be in a position to earn excessive interest on grant advances. If funds were properly released, interest the state might earn would be too small to be a matter of concern. The statutory exception was not intended to create a windfall for state grantees. The situation did not prove satisfactory, however. Grantor agencies complained of premature drawdown of grant advances; states complained of slow federal payment in reimbursement situations. Congress responded by amending the IGCA by section 5 of the Cash Management Improvement Act of 1990 (CMIA), Pub. L. No. 101-453,104 Stat. 1058,1059.

The revised 31 U.S.C. § 6503 retains the general requirement to minimize the time elapsing between transfer of funds from the Treasury and grantee disbursement for program purposes. Id. § 6503(a). It then requires the Secretary of the Treasury to enter into an agreement with each state which receives federal grant funds prescribing fund transfer methods and procedures, as chosen by the state and approved by the Secretary. Id. § 6503(b). If an agreement cannot be reached with a particular state, the Secretary is authorized to establish procedures for that state by regulation, Id. § 6503(b)(3).

For advance payment programs, unless inconsistent with program purposes, the state must pay interest to the United States from the time the funds are transferred to the state's account to the time they are paid out by the state for program purposes. Interest payments are to be deposited in the Treasury as miscellaneous receipts. Id. § 6503(c). For reimbursement situations, the United States-must pay interest to the state from the time of payout by the state to the time the federal funds are deposited in the state's bank account. The law includes a permanent, indefinite appropriation from the general fund

[25] In B-146285, April 10, 1978, GAO concluded that this provision did not repeal by implication a statute which prescribed both the timing schedule and the amount of payments under a particular assistance program, but rather was geared primarily to programs without statutory payment schedules.

of the Treasury for this purpose. Id. § 6503(d). Interest in both directions is to be paid annually, at a rate based on the yield of 13-week Treasury bills, using offset to the extent provided in Treasury regulations. Id. §§ 6503(c), (d), and (i). The interest provisions of the CMIA take effect during the second half of 1993. Pub. L. No. 101-453, § 5(e), as amended by Pub. L. No. 102-589,$2 (1992).

The original IGCA applied only to states and their agencies or "instrumentalities." It did not extend to governments of "political subdivisions" of states such as cities, towns, counties, or special districts created by state law. The CMIA revision applies to "an agency, instrumentality, or fiscal agent" of a state, including territories and the District of Columbia, but retains the exclusion for "a local government of a State." 31 U.S.C. § 6501(9), amended by CMIA § 5(a), 104 Stat. at 10.59. Thus, decisions under the 1968 law should remain relevant in determining which entities and situations are now covered by the CMIA and which remain subject to the decisional rules.

In 56 Comp. Gen. 353 (1977), the Comptroller General considered the basis for determining which state entities were covered by the IGCA, concluding as follows:

"[A] Federal grantor agency is not required by the Intergovernmental Cooperation Act of 1968 and its legislative history to accept the Bureau of the Census' classification of an entity . . . in determining whether that entity is a State agency or instrumentality or a political subdivision of the State. It is bound by the classification of the entity in State law. Only in the absence of a clear indication of the status of the entity in State law may it make its own determination based on reasonable standards, including resort to the Bureau of the Census' classifications." Id. at 357.

If the classification under state law is not clear and unambiguous, the grantee may be required to obtain a legal opinion from the state Attorney General in order to assist in making the determination. Id.

The exception for states in the 1968 IGCA was held to apply to pass-through situations where states are the primary recipients of grant funds which are then passed onto subgrantees. In B-171019, October 16, 1973, the Comptroller General concluded that the exception applied to political subdivisions which were subgrantees of states. The Justice Department reached the same conclusion in 6 Op. Off. Legal Counsel 127 (1982). Subsequent decisions applied the exception to nongovernmental subgrantees as well, recognizing that

there was no basis to distinguish between governmental and nongovernmental subgrantees. 59 Comp. Gen. 218 (1980), aff'd, B-196794, February 24, 1981.

The authority of a state to require its own grantees to account to it for funds it makes available to them is a matter within the discretion of the state. See B-196794, January 28,1983 (non-decision letter).

Other cases under the pre-CMIA version of the IGCA may remain relevant as well. For example, the statute does not necessarily apply to funds in contexts other than those specified. Thus, in 62 Comp. Gen. 701 (1983), the Comptroller General concluded that a subgrantee under a Labor Department grant to a state was not entitled to retain interest it had earned by investing funds received from the Internal Revenue Service as a refund of Federal Insurance Contributions Act (social security) taxes. In North Carolina v. Heckler, 584 F. Supp. 179 (E. D.N.C. 1984), the court found the statute inapplicable in a situation where the state had wrongfully obtained federal funds and earned interest on them pending repayment to the government.

4. Program Income

Once grant funds have been applied to their grant purposes, they still can generate income, directly or indirectly, in various ways. This-as distinguished from interest on grant advances-is called "program income. "

Program income may be defined as "gross income received by the grantee or subgrantee directly generated by a grant supported activity, or earned only as a result of the grant agreement during the grant period." Common Rule §—.25(b), 53 Fed. Reg. 8093. It may include such things as income from the sale of commodities, fees for services performed, and usage or rental fees. Id. §__.25(a); OMB Circular No. A-1 10, Attachment D. Grant generated income may also include investment income, although this will be uncommon. See B-192459, July 1, 1980.

In contrast with income earned on grant advances, program income does not automatically acquire a federal character and is not required to be deposited in the Treasury as miscellaneous receipts. It may, unless the grant provides otherwise, be retained by the grantee for grant-related use. 44 Comp. Gen. 87 (1964); 41 Comp. Gen. 653

(1962); B-192459, July 1, 1980; B-191420, August 24,1978. In 44 Comp. Gen. 87, the Comptroller General concluded that a grantee could establish a revolving fund with grant income in the absence of a contrary provision in the grant agreement. However the initial amount of a revolving fund established from either the principal of a grant or the income generated under the. grant, when returned to the grantor agency upon completion of the grant, may not be considered a return of grant funds for further use by the grantor but must be deposited in the Treasury as miscellaneous receipts. B-154996, November 5, 1969.

There are three generally recognized methods for the treatment of program income:

(1) Deduction. Deduct program income from total allowable costs to determine net costs on which grantor and grantee shares will be based. This approach results in savings to the federal government because the income is used to reduce contributions rather than to increase program size.

(2) Addition. Add income to the funds committed to the project, to be used for program purposes. This approach increases program size.

(3) Cost-sharing. Use income to meet any applicable matching requirements. Under this approach, the federal contribution and program size remain the same.

Both OMB and GAO have expressed preference for the deduction method since it results in savings to the federal government and to grantees, and it is the preferred method under OMB Circular A-102, although grantor agencies have a measure of discretion. See OMB Circular A-102, para. 7.e; Supplementary Information Statement on revised circular, 53 Fed. Reg. at 8029; Common Rule §___.25(g), 53 Fed. Reg. at 8093; Supplementary Information Statement on common rule, 53 Fed. Reg. at 8038. See also GAO report entitled Improved Standards Needed for Managing and Reporting Income Generated Under Federal Assistance Programs, GAO/GGD-83-55 (July 22, 1983). (This report was issued several years prior to the revision of OMB Circular A-102 and issuance of the Common Rule).

Some types of program income are subject to special rules:

- Rules relating to proceeds from the sale of real and personal property provided by the federal government or purchased in whole or in part with federal funds are set forth in the Common Rule §§__.25(f), —.31, and —.32, 53 Fed. Reg. 8093–95. See also OMB Circular A-110, Attachment N.
- Royalties received as a result of copyrights or patents produced under a grant maybe treated as other program income if specified in applicable agency regulations or the grant agreement. Common Rule §__.25(e), 53 Fed. Reg. 8093. See also B-186284, June 23, 1977; GAO report entitled Administration of the Science Education Project "Man: A Course of Study" (MACOS), MWD-76-26 (October 14, 1975).

5. Cost-Sharing

When the federal government chooses to provide financial assistance to some activity, it may also choose to fund the entire cost, but it is not required to do so. City of New York v. Richardson, 473 F.2d 923, 928 (2d Cir. 1973), cert. denied, 412 U.S. 950. "[T]he judgment whether to [provide assistance], and to what degree, rests with [Congress]." Id. Thus, a program statute may provide for full funding, or it may provide for "cost-sharing," that is, financing by a mix of federal and nonfederal funds. Reasons for cost-sharing range from budgetary considerations to a desire to stimulate increased activity on the part of the recipient. The two primary cost-sharing devices are "matching share" provisions and "maintenance of effort" provisions. For a detailed analysis and critique of both devices, see GAO's report Proposed Changes in Federal Matching and Maintenance of Effort Requirements for State and Local Governments, GGD-81-7 (December 23, 1980) (hereafter cited as "GGD-81-7").

Federal grant funds constitute a significant portion of the total expenditures of state and local governments. Thus, cost-sharing clearly has an impact on the relationship between the federal government and the states, and on the executive-legislative relationship at the state level. This gives rise to many interesting problems,[26] discussed in detail in GAO's report Federal Assistance System Should Be Changed to Permit Greater Involvement by State Legislatures, GGD-81-3 (December 15, 1980).

[26]For example, can a state legislature appropriate federal grant funds? State courts have split on the issue. See GGD-81-3 at 27-30.

a. Local or Matching Share

(1) General principles

A matching share provision is one under which the grantee is required to contribute a portion of the total project cost. The "match" maybe 50-50, or any other mix specified in the governing legislation. A matching share provision typically prescribes the percentages of required federal and nonfederal shares. However, the legislation need not provide explicitly for a nonfederal share. A statute authorizing assistance not in excess of a specified percentage of project costs will normally be interpreted as requiring a local share of nonfederal funds to makeup the difference. (The rest of the money has to come from someplace.) B-214278, January 25, 1985 (construing a provision of the Consolidated Farm and Rural Development Act authorizing water and waste disposal grants).

When a federal agency enters into an assistance agreement with an eligible recipient, an entire project or program is approved. Where a local share is required, this agreement includes an estimate of the total costs, that is, a total which will exceed the amount to be borne by the federal government. The additional contribution which is needed to supply full support for the anticipated costs is the local or nonfederal matching share. Once the agreement is accepted, the assistance recipient is committed to provide the nonfederal share if it wishes to continue with the grant. E.g., B-130515, July 20, 1973. Failure to meet this commitment may result in the disallowance of all or part of otherwise allowable federal share costs.

Matching share requirements are often intended to "assure local interest and involvement through financial participation." 59 Comp. Gen. 668,669 (1980). They may also serve to hold down federal costs. The theory behind the typical matching share requirement may be summarized as follows:

> "In theory, the fiscal lure of Federal grants entices State and local governments into allocating new resources to satisfy the non-Federal match for program they otherwise would not have funded on their own. While State and local jurisdictions may not be willing or able to fully fund a program from their own resources, they would most likely agree to spend new resources on the same project if most of the project costs were paid by the Federal Government."

GGD-81-7 at 9. This approach has been termed "cooperative federalism." E.g., King v. Smith, 392 U.S. 309,316 (1968). It is also

known as the "federal carrot." See City of New York v. Richardson, 473 F.2d at 928.

Matching requirements are most commonly found in the applicable program legislation. However, they may also be found in appropriation acts. E.g., 58 Comp. Gen. 524 (1979); 31 Comp. Gen. 459 (1952). A matching provision in an appropriation act, like any other provision in an appropriation act, will apply only to the fiscal year(s) covered by the actor the appropriation to which it applies, unless otherwise specified. 58 Comp. Gen. at 527.

If a program statute authorizes grants but neither provides for nor prohibits cost-sharing, the grantor agency may in some cases be able to impose a matching requirement administratively by regulation. The test is the underlying congressional intent. If legislative history indicates an intent for full federal funding, then the statute will generally be construed as requiring a 100 percent federal share. B-226572, June 25, 1987; B-169491, June 16, 1980. However, cost-sharing regulations have been regarded as valid where the statute was silent and it could reasonably be concluded that Congress left the matter to the judgment of the administering agency. B-130515, July 17, 1974; B-130515, July 20, 1973. Such regulations may be waived uniformly and prospectively, but may not be waived on a retroactive and ad hoc basis. Id.

Matching funds, as with the federal assistance funds themselves, can be used only for authorized grant purposes. B-230735, July 20, 1988; B-149441, February 17, 1987. In the latter case, GAO concluded that the National Endowment for the Humanities could not divert state matching funds to establish private endowments which, under existing authorities, could not have been created by a direct award of NEH funds. See also 42 Comp. Gen. 289,295 (1962).

Unless otherwise specified in the governing legislation, a grantee may match only a portion of the funds potentially available to it, and thereby receive a correspondingly smaller grant. 16 Comp. Gen. 512 (1936).

Under a cost-sharing assistance program funded by advance payments of the federal contribution, the Comptroller General has held that the advances may be made prior to the disbursement of the nonfederal share as long as adequate assurances exist (e.g., by

contractual commitments) that the local share will be forthcoming. 60 Comp. Gen. 208 (1981). See also 23 Comp. Gen. 652 (1944) (payment by federal agency of local share under cooperative agreement, subject to contractual agreement to reimburse).

Where the statute authorizing federal assistance specifies the federal share of an approved program as a specific percentage of the total cost, the grantor agency is required to make awards to the extent specified and has no discretion to provide a lesser (or greater) amount. Manatee County v. Train, 583 F.2d 179, 183 (5th Cir. 1978); 53 Comp. Gen. 547 (1974); B-197256, November 19, 1980. However, where the federal share is defined by statutory language which specifies a maximum federal contribution but no minimum, the agency can provide a lesser amount. 50 Comp. Gen. 553 (1971).

Although most cost-sharing programs are in terms of a fixed federal share, some programs may provide for a declining federal share. Under a declining share program in the Regional Rail Reorganization Act, GAO concluded that the federal share could be determined in the year the grant was made, notwithstanding the fact that the grantee would not actually incur the costs until the following fiscal year. B-175155, July 29, 1977. Another cost-sharing variation is the "aggregate match, " in which the nonfederal share is determined by cumulating the grantee's contributions from prior time periods. An example is discussed in 58 Comp. Gen. 524 (1979).

(2) Hard and soft matches

The program statute may define or limit the types of assets which may be applied to the nonfederal share. A provision limiting the nonfederal share to cash contributions is called a "hard match." In 31 Comp. Gen. 459 (1952), the matching share was described in the appropriation act that required it as an "amount available." In the absence of legislative history to support a broader meaning, GAO concluded that the matching share must be in the form of money and that the value of other non-monetary contributions could not be considered. A more explicit "hard match" requirement is discussed in 52 Comp. Gen. 558 (1973), in which GAO concluded that the matching share, while it must be in the form of money, could include donated funds as well as grantee funds. While the program discussed in 52 Comp. Gen. 558 no longer exists, the case remains useful for this

point and for the detailed review of legislative history illuminating the purpose and intent of the 'hard match" provision.

The program legislation may expressly authorize the inclusion of assets other than cash in the nonfederal contribution. See 56 Comp. Gen. 645 (1977). If the legislation is silent with respect to the types of assets which may be counted, the statute will generally be construed as permitting an "in-kind" or "soft" match, that is, the matching share may include the reasonable value of property or services as well as cash. 52 Comp. Gen. 558, 560 (1973); B-81321, November 19, 1948. The valuation of in-kind contributions can get complicated. An example is 31 Comp. Gen. 672 (1952) (value of land could not include the cost or value of otherwise unallowable improvements to the land previously added by the grantee). Current valuation standards for state and local governments are found in the Common Rule, §___.24,53 Fed. Reg. 8092.

(3) Matching one grant with funds from another

An important and logical principle is that neither the federal nor the nonfederal share of a particular grant program maybe used by a grantee to match funds provided under another federal grant program, unless specifically authorized by law. In other words, a grantee may not (1) use funds received under one federal grant as the matching share under a separate grant, nor may it (2) use the same grantee dollars to meet two separate matching requirements. 56 Comp. Gen. 645 (1977); 47 Comp. Gen. 81 (1967); 32 Comp. Gen. 561 (1953); 32 Comp. Gen. 141 (1952); B-214278, January 25, 1985; B-212177, May 10, 1984; B-130515, July 20, 1973; B-229004 -0. M., February 18, 1988; B-162001 -O. M., August 17, 1967. See also Common Rule § .24(b), 53 Fed. Reg. 8092. A contrary rule would largely nullify the cost-sharing objective of stimulating new grantee expenditures.[27]

Normally, exceptions to the rule are in the form of express statutory authority. A prominent example is section 105(a)(9) of the Housing and Community Development Act of 1974, 42 U.S.C. § 5305(a)(9),

[27] By way of contrast, the rule that funds received under one federal grant may not, absent congressional authorization, be used to finance the local match under another federal grant, does not apply to federal loans. The reason is that loans, unlike grants, are expected to be repaid and the recipient is thus, at least ultimately, using its own funds. Of course, the proposed use of the funds must be authorized under the loan program legislation. B-20721 I-O. M., July 9, 1982. See also B-214278, January 25, 1985.

which authorizes community development block grant funds to be used as the nonfederal share under any other grant undertaken as part of a community development program. See 59 Comp. Gen. 668 (1980); 56 Comp. Gen. 645 (1977); B-239907, July 10,1991. The latter opinion concluded that community development block grant regulations no longer apply once the funds have been applied as a match under another grant program, at least where applying the regulations would substantially interfere with use of the funds under the receiving grant. For other examples, see 52 Comp. Gen. 558,564 (1973) and 32 Comp. Gen. 184 (1952).

In 59 Comp. Gen. 668, GAO considered a conflict between two statutes-the Housing and Community Development Act which, as noted, permits federal grant funds to fill a nonfederal matching requirement, and the Coastal Zone Management Act, which provides for cost-sharing grants but expressly prohibits the use of federal funds received from other sources to pay a grantee's matching share. Finding that the statutory language could not be reconciled, and noting further that there was no helpful legislative history under either statute, the Comptroller General concluded, as the most reasonable result consistent with the purposes of both statutes, that community development block grant funds were available to pay the nonfederal share of Coastal Zone Management Act grants for projects properly incorporated as part of a grantee's community development program. See also B-229004-O. M., February 18, 1988, which essentially followed 59 Comp. Gen. 668 and concluded that community development block grant funds could be used for the matching share of certain grants under the Stewart B. McKinney Homeless Assistance Act of 1987.

A somewhat less explicit exception is discussed in 57 Comp. Gen. 710 (1978), holding that funds distributed to states under Title II of the Public Works Employment Act of 1976,42 U.S.C. $$6721-6736 (called the "countercyclical revenue sharing program"), maybe applied to the states' matching share under the Medicaid program. GAO agreed with the Treasury Department that Title II payments amounted to "general budget support as opposed to categorical or block grants or contracts" (57 Comp. Gen. at 711)–a form of revenue sharing–and thus should be construed in the context of the (since repealed) General Revenue Sharing Program. General Revenue Sharing was characterized by a "no strings on local expenditures" policy, evidenced by the fact that a provision in the original legislation

barring the use of funds as the nonfederal share in other federal programs had been repealed. Stressing the strong analogy between Title II and General Revenue Sharing, the decision concluded that implicit in the "no strings" policy was the authority to apply Title II funds to a state's matching share under Medicaid.

It should also be noted that where any federal assistance funds are used as nonfederal matching funds for another grant, such use must be consistent with the grant under which they were originally awarded as well as the grant they are intended to implement. 59 Comp. Gen. 668 (1980); 57 Comp. Gen. at 715; B-230735, July 20, 1988.

Funds received by a property owner from a federal agency as just compensation for property taken by eminent domain belong to the owner outright and do not constitute a "grant." Therefore, they may be used as the nonfederal share of a grant from another federal agency, even where the taking and the grant relate to the same project. B-197256, November 19, 1980.

(4) Relocation allowances

Federally assisted programs which result in the displacement of individuals and business entities may, apart from eminent domain payments, result in the payment of relocation allowances under the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970. Under the statute, authorized relocation payments provided by a state incident to a federally assisted project which results in relocations are to be treated in the same manner as other project costs. Thus, under a program statute which provides for a 90 percent federal contribution, 90 percent of authorized relocation payments will be reimbursable as an allowable program cost. In other words, any applicable matching share requirement will apply equally to the relocation payments. B-215646, August 7, 1984.

(5) Payments by other than grantor agency

Of course there is nothing wrong with grantees receiving funds under more than one grant for which they are eligible. If the grants are administered by different agencies, each agency is making payments under its own program. Occasionally, an agency is asked to make payments not associated with any of its own assistance programs, to a

grantee or grant beneficiary under some other agency's program. The cases fall into two groups.

The first situation involves services performed by an assistance beneficiary to an agency other than the grantor agency. Under the College Work-Study Program, not to exceed 70 percent of the student's salary is paid by the college under a Department of Education grant, with the remainder paid by the employer. 42 U.S.C. § 2753(b)(5). The "employer" maybe another federal agency. 46 Comp. Gen. 115 (1966). In addition to the salary contribution, the employing agency may pay unreimbursed administrative costs such as social security taxes and compensation insurance. 50 Comp. Gen. 553 (1971); 46 Comp. Gen. 115. However, an agency may not, without statutory authority, participate in a work-study program authorized by state law and not coordinated with the federal program. B-159715, December 18, 1978.

The authority to pay administrative costs under the work-study program is based on the cost-sharing nature of that program. Absent cost-sharing, there is no comparable authority. 61 Comp. Gen. 242 (1982) (agency to which employee had been assigned under former Comprehensive Employment and Training Act lacked authority to reimburse grantee for retirement contributions).

The second group of cases involves projects which benefit other federal facilities. Under program legislation which does not give the grantor agency discretion to reduce the federal share, the grantor agency is not authorized to exclude from total cost a portion of an otherwise eligible project solely because that portion would provide service to another federal facility. 59 Comp. Gen. 1 (1979). Where the grantor agency has reduced its contribution because a portion of the project would serve another federal facility, the "benefited agency" normally would not be authorized to make up the shortfall without receiving additional consideration above and beyond the improved service it would have received anyway. B-189395, April 27, 1978. However, if Congress chooses to appropriate funds to the benefited agency to make up the shortfall, the benefited agency may make otherwise proper contributions without requiring additional legal consideration as long as its contribution, when added to the amount contributed by the grantor agency, does not exceed the statutorily specified federal share. 59 Comp. Gen. 1; B-198450, October 2, 1980; B-199534/B-200086, October 2, 1980.

The illustration given in 59 Comp. Gen. 1 may help to clarify these principles. Suppose the statutory federal share is 75 percent and the total project cost is $10 million. The federal share is 75 percent of 10 million, or $7.5 million. Now suppose the grantor agency determines that 20 percent of the project will serve another federal facility. Under 59 Comp. Gen. 1, it is improper for the grantor agency to reduce total cost by 20 percent (i.e., from $10 million to $8 million) and to then contribute only 75 percent of the $8 million, for a federal share of $6 million. The correct federal share should have remained 75 percent of $10 million.

Suppose further that the grantor agency has made the reduction and Congress appropriates money to the benefited agency to make up the shortfall. Using the same hypothetical figures, the benefited agency may contribute $1.5 million (20 percent of the federal share of $7.5 million) as the federal share of that portion of the project attributable to its use, without further legal consideration. However, as mentioned above, its contribution, when added to the contribution of the grantor agency, may not exceed the specified statutory share unless further legal consideration is received by the government.

The decision at 59 Comp. Gen. 1 and the two October 1980 unpublished decisions resulted from a disagreement between GAO and the Environmental Protection Agency over grant funding policy under the Federal Water Pollution Control Act. The Act authorized EPA to make 75 percent [28] construction grants for wastewater treatment systems. EPA construed the statute as permitting it to proportionately reduce its contribution to the extent a project benefits other federal facilities. As noted, GAO concluded that EPA lacked authority to reduce its contribution below 75 percent, and that the benefited agencies could not make up the shortfall. EPA disagreed, and to resolve the funding impasse, Congress, apparently as a temporary expedient, provided funds to certain agencies, specifically the Army and the Navy. However, Congress did not provide funds for the Air Force to offset the reduced grants, and the issue arose again in B-194912, August 24, 1981. The Comptroller General reaffirmed GAO's position and concluded that, absent specific congressional approval, the appropriations of the Air Force were not available to make up for the reduced grant amounts.

[28] Subsequent legislation reduced the percentage of the federal share under this program. See B-20721 1-O.M., July 9, 1982, for a general discussion of matching share requirements in Federal Water Pollution Control Act wastewater treatment construction grants.

b. Maintenance of Effort

Suppose the state of New Euphoria spends around a million dollars a year for the control of noxious pests. After several years, the continued proliferation of noxious pests leads Congress to conclude that the program is not going as well as everyone might like, and that federal financial assistance is in order. Congress therefore enacts legislation and appropriates funds to provide annual pest-control grants of half a million dollars to each affected state.

New Euphoria applies for and receives its grant. Like most other states, however, New Euphoria is strapped for money and faced with various forms of taxpayer revolt. While the state government certainly believes that noxious pests merit control, it would, if it had free choice in the matter, rather use the money on what it regards as higher priority programs. The state uses the $500,000 federal grant for its pest control program–it has no choice because it has contractually committed itself with the federal government to do so as a condition of receiving the grant. However, it then takes $500,000 of its own money away from pest control and applies it to other programs. If the purpose of the federal grant legislation is simply to provide general financial support to New Euphoria, that purpose has been accomplished and the state has clearly benefited. But if the federal purpose is to fund an increased level of pest control activity, the objective has just as clearly been frustrated.

When Congress wants to avoid this result, a device it commonly uses is the "maintenance of effort" requirement. Under a maintenance of effort provision, the grantee is required, as a condition of eligibility for federal funding, to maintain its financial contribution to the program at not less than a stated percentage (which maybe 100 percent or less) of its contribution for a prior time period, usually the previous fiscal year. The purpose of maintenance of effort is to ensure that the federal assistance results in an increased level of program activity, and that the grantee, as did New Euphoria, does not simply replace grantee dollars with federal dollars. GAO has observed that maintenance of effort, since it requires a specified level of grantee spending, "effectively serves as a matching requirement." GGD-81-7 at 2.

GAO has also observed that a grant for something the grantee is already spending its own money on is, without maintenance of effort, little more than another form of revenue sharing.

"When Federal grant money is used to substitute for ongoing or planned State and local expenditures, the ultimate effect of the Federal program funds is to provide fiscal relief for recipient States and localities rather than to increase service levels in the program area. When fiscal substitution occurs, narrow-purpose categorical Federal programs enacted to augment service levels are transformed, in effect, into broad purpose fiscal assistance like revenue sharing Maintenance of effort provisions, if effective, can prevent substitution and ensure that the Federal grant is used by the grantee for the specific purpose intended by the Congress." GGD-81-7 at 48–49.

One type of maintenance of effort requirement is illustrated by the following provision from the Clean Air Act:

"No [air pollution control] agency shall receive any grant under this section during any fiscal year when its expenditures of non-Federal funds for recurrent expenditures for air pollution control programs will be leas than its expenditures were for such programs during the preceding fiscal year. . . ."

42 U.S.C. § 7405(c), amended by Pub. L. No. 101-549, $ 802(e), 104 Stat. 2399,2688 (1990).

A variation is found in 20 U.S.C. $2971, applicable to certain education grants, which we chose because it includes most of the points we will note in this discussion. The basic requirement is subsection (a)(l):

"[A] State is entitled to receive its full allocation of funds. . . for any fiscal year if the Secretary finds that either the combined fiscal effort per student or the aggregate expenditures within the State with respect to the provision of free public education for the preceding fiscal year was not less than 90 percent of such combined fiscal effort or aggregate expenditures for the second preceding fiscal year."

Maintenance of effort statutes will invariably provide fiscal sanctions if the grantee does not meet its commitment. Sanction provisions are of two types. Under one version, the grantee's allocation of federal funds is reduced in the same proportion as its contribution fell below the required level. For example, 20 U.S.C. § 2971(a)(2) provides:

"The Secretary shall reduce the amount of the allocation of funds under this division in any fiscal year in the exact proportion to which the State fails to meet the requirements of paragraph (1) by falling below 90 percent of both the fiscal effort per student and aggregate expenditures . . . ."

The second and more draconian version is illustrated by the Clean Air Act provision quoted above and discussed in B-209872 -0. M., March 23, 1984, an internal GAO memorandum. Under this version,

the grantee falling short of its maintenance of effort commitment loses all grant funds under the program for that fiscal year. GAO has endorsed the enactment of legislation making proportionate reduction the standard rather than total withdrawal. GGD-81-7 at 71.

Some maintenance of effort statutes authorize the administering agency to waive the requirement for a specified time period if some natural disaster or other unforeseen event caused the funding shortfall. An illustration is 20 U.S.C. § 2971(a)(3):

"The Secretary may waive, for 1 fiscal year only, the requirements of this subsection if the Secretary determines that such a waiver would be equitable due to exceptional or uncontrollable circumstances such as a natural disaster or a precipitous and unforeseen decline in the financial resources of the State."

If a grantee fails to meet its commitment and the noncompliance cannot be waived, any disbursement of federal funds in excess of the amount permitted by the program statute must generally be recovered. 51 Comp. Gen. 162 (1971). Failure to require repayment of such funds "would, in effect, constitute the giving away of United States funds without authority of law." Id. at 165.

A variation of the maintenance of effort provision is the so-called "nonsupplant" provision, which requires that federal funds be used to supplement, and not supplant, nonfederal funds which would otherwise have been made available. Nonsupplant is sometimes used in conjunction with maintenance of effort, an example again being the education statute, 20 U.S.C. § 2971(b):

"A State or local educational agency may use and allocate funds received under this division only so as to supplement and, to the extent practical, increase the level of funds that would, in the absence of Federal funds made available under this division, be made available from non-Federal sources, and in no case may such funds be used so as to supplant funds from non-Federal sources."

The Clean Air Act provision, quoted in part above, also includes a nonsupplant clause. GAO's 1980 study concluded that nonsupplant provisions were largely unenforceable, and recommended against their use. GGD-81-7 at 71.[29]

F. Obligation of Appropriations for Grants

1. Requirement for Obligation

As with any other type of expenditure, the expenditure of federal assistance program funds requires an obligation that is proper in terms of purpose, time, and amount, and the obligation must be properly recorded. The purpose, time, and amount requirements are essentially the same for grants as for other expenditures. With respect to recording of the obligation, 31 U.S.C. § 1501(a)(5) requires that the obligation be supported by documentary evidence of a grant payable—

"(A) from appropriations made for payment of, or contributions to, amounts required to be paid in specific amounts fixed by law or under formulas prescribed by law;

"(B) under an agreement authorized by law; or

"(C) under plans approved consistent with and authorized by law."

What constitutes an obligation in the grant context, and what will or will not satisfy 31 U.S.C. § 1501(a)(5), are discussed in more detail in Chapter 7.

[29] "Most Federal program officials we contacted agreed that nonsupplant is difficult, if not impossible, to enforce because it calls for an external judgment on what grantees would have done if Federal funds were not available. Basically, this calls for a Federal agency to assess the motives behind particular changes in State and local plans or budgets and to judge whether the presence of Federal grant funds drove the particular State or local action." GGD-81-7 at 54.

2. Changes in Grants—Replacement Grants vs. New Obligations

a. The Replacement Grant Concept

Changes in grants may come about for a variety of reasons-the original grantee may be unable to perform, the grant amount maybe increased, there may be a redefinition of objectives, etc. If the change occurs in the same fiscal year (or longer period if a multiple-year appropriation is involved) in which the original grant was made, there is no obligation problem as long as the amount of the appropriation is not exceeded. If, however, the change occurs in a later fiscal year, the question becomes whether the amended grant remains chargeable to the appropriation initially obligated or whether it constitutes a new obligation chargeable to appropriations current at the time the change is made.

As a general proposition, a grant amendment which changes the scope of the grantor which makes the award to an entirely different grantee (not a successor to the original grantee), and which is executed after the appropriation under which the original grant was made has ceased to be available for obligation, may not be charged to the original appropriation. E.g., 58 Comp. Gen. 676 (1979). If the amendment amounts to a substitute grant, it extinguishes the old obligation and creates a new one. The new obligation is chargeable to the appropriation available at the time the new obligation is created. There are also situations where a grant amendment creates a new obligation chargeable to the later appropriation without extinguishing the original obligation. In either event, if the grantor agency does not recognize that the change creates a new obligation when the change is made, there is a potential Antideficiency Act violation. On the other hand, a change which qualifies as a "replacement grant" remains chargeable to the original appropriation. Of course, an agency with the requisite program authority can change the scope of a grant if current appropriations are used. 60 Comp. Gen. 540 (1981).

The clearest example of a change that creates a new obligation is where the amount of the award is increased. If the grantee has no legal right stemming from the original grant agreement to compel execution of the amendment, the increase in amount is anew obligation chargeable to appropriations current when the change is made. 41 Comp. Gen. 134 (1961); 39 Comp. Gen. 296 (1959); 37 Comp. Gent 861 (1958). However, an upward adjustment in a

"provisional indirect cost rate" contained in a grant award, which contemplated a possible increase in the indirect cost rate at a later date, does not constitute an additional or new award. Payments resulting from such an adjustment are chargeable to the appropriation originally obligated by the grant. 48 Comp. Gen. 186 (1968).

Where a change involves some other aspect of the grant, it is necessary to determine whether the change, viewed as a whole, w-ill create a new and separate undertaking or will enlarge the scope of the grant, thereby creating anew obligation. As pointed out in 58 Comp. Gen. 676,680 (1979), the cases have identified three closely related areas of concern that must be satisfied before a change maybe viewed as a "replacement grant" and not as creating anew obligation:

(1) The bona fide need for the grant project must continue;

(2) The purpose of the grant from the government's standpoint must remain the same: and

(3) The revised grant must have the same scope,

The "scope" of a grant, as stated in 58 Comp. Gen. at 681:

"grows out of the grant purposes. These purposes must be referred to in order to identify those aspects of a grant that make up the substantial and material features of a particular grant which in turn fix the scope of the Government's obligation. "

b. Substitution of Grantee

As a general rule, when a recipient of a grant is unable to implement the grant as originally contemplated, and an alternative grantee is designated subsequent to the expiration of the period of availability for obligation of the grant funds, the award to the alternative grantee must be treated as a new obligation and is not properly chargeable to the appropriation current at the time the original grant was made. B-164031(5), June 25, 1976; B-114876/A-44014, January 21, 1960.

However, it is possible in certain situations to make an award to an alternative grantee after expiration of the period of availability for obligation where the alternative award amounts to a "replacement grant" and is substantially identical in scope and purpose to the original grant. 57 Comp. Gen. 205 (1978); B-157179, September 30, 1970. In the latter decision, the Comptroller General did not object to the use of unexpended grant funds originally awarded to the

University of Wisconsin to engage Northwestern University in a new fiscal year to complete the unfinished project. Approval was granted because the project director had transferred from the University of Wisconsin to Northwestern, University and he was viewed by all the parties as the only person capable of completing the work. The decision also noted that the original grant was made in response to a bona fide need then existing, and that the need for completing the project continued to exist.

GAO has also indicated that it might be possible in certain situations to develop procedures to designate an alternate grantee at the time an award is made to the principal grantee, provided that all of the criteria for selection of the principal and required administrative action are also met concerning the alternate, with the sole exception that the award to the alternate is not mailed to it pending a determination as to whether the principal actually complies with the terms of the award. The validity of any such procedure would have to be assessed on a case-by-case basis. B-1 14876, July 29, 1960; B-1 14876, March 15, 1960.

c. Other Changes

A shift in the community to be served by the grant has been held to constitute a new obligation. Thus, in B-164031(5), June 25, 1976, the original grantee ran into financial difficulties and was unable to utilize a hospital modernization award under the Hill-Burton program. The Comptroller General found that a proposal to shift the award to another hospital would constitute a new undertaking rather than a replacement grant since the hospitals were over 100 miles apart and served essentially different communities.

An enlargement of the community to be seined will not necessarily constitute a new obligation. The grant in 58 Comp. Gen. 676 (1979) was to set up a demonstration community service volunteer program. The grant defined the number of participants deemed necessary to generate the desired test results. The geographic site for which the grant was awarded was expected to produce the necessary number of volunteers, but did not. It was held that the geographical area could be expanded to produce the desired number of volunteers. The modification in these circumstances would not constitute a new and separate undertaking and could be funded from the appropriation originally obligated.

A change in the research objectives of a grant will constitute a new obligation notwithstanding that some aspects of the original grant and the modification may be related. 57 Comp. Gen. 459 (1978). See also 39 Comp. Gen. 296 (1959).

A 1969 decision involved amendments by the National Institute of Mental Health which would change the use of grant funds from construction to renovation and vice-versa beyond the period of obligational availability. Since the amendments met the statutory eligibility criteria, since they would still accomplish the original grant objectives, and since they involved neither a change in grantees nor an increase in amount, they were held permissible under the original obligations. B-74254, September 3, 1969.

G. Grant Costs

1. Allowable vs. Unallowable Costs

a. The Concept of Allowable costs

Recipients of assistance awards are expected to use the assistance funds for the purposes for which they were awarded, subject to any conditions that may attach to the award. Expenditures or costs that meet the grant purposes and conditions are termed "allowable costs." An expenditure which is not for grant purposes or is contrary to a condition of the grant is not an allowable cost and may not be properly charged to the grant.

Where a cost is not allowable, as far as the government is concerned the recipient still has the funds. If the grant funds have already been paid over to the grantee and no allowable costs of an equal amount are subsequently incurred, the recipient is required to return the amount of the improper charge to the government. E.g., Utah State Board for Vocational Education v. United States, 287 F.2d 713 (10th Cir. 1961). The United States "has a reversionary interest in the unencumbered balances of such grants, including any funds improperly applied." 42 Comp. Gen. 289, 294 (1962). See also B-198493, July 7, 1980. This requirement cannot be waived. B-171019, June 3, 1975. Thus, the Comptroller General has held that an agency cannot waive its statutory regulations to relieve a grantee of its liability for improper expenditures. B-163922, February 10, 1978.

Similarly, an agency may not amend its regulations to relieve a grantee's liability for expenditures for administrative costs in excess of a statutory limitation. B-178564, July 19, 1977, reaffirmed in 57 Comp. Gen. 163 (1977).

Guidance from the Office of Management and Budget on cost principles is found in a series Of OMB Circulars: A-21 (Cost Principles for Educational Institutions); A-87 (Cost Principles for State and Local Governments); A-1 22 (Cost Principles for Nonprofit Organizations). These circulars are expressly incorporated in the common rule adopted under OMB Circular No. A-102. Common Rule §—.22, 53 Fed. Reg. 8092.

Costs are of two types, direct and indirect. Direct costs are items that are specifically identifiable and attributable to a particular cost objective.[30] In other words, direct costs are obligations or expenditures of a recipient which can be tied to a particular award. For example, if a recipient purchases an item of equipment necessary to carry out a particular award, the purchase price is a direct cost under that award. Indirect costs are costs incurred for common objectives which cannot be directly charged to any single cost objective.[31] A common example is depreciation. The concept of indirect costs is essentially an accounting device to permit the allocation of overhead in proportion to benefit. See B-203681, September 27, 1982. Indirect cost rates are usually negotiated by the grantor and grantee.

The overallocation of indirect costs is unauthorized and therefore unallowable. The reason is that 31 U.S.C. § 1301(a) restricts the use of appropriated funds to the purposes for which they were appropriated, and payment of the overallocation would not serve the purposes of the appropriation. B-203681, September 27, 1982.

A grantee may generally substitute other allowable costs for costs which have been disallowed, subject to any applicable cost ceiling. If additional funds become available as the result of a cost disallowance, those funds should be used to pay any "excess" allowable costs which could not be paid previously because of the ceiling. B-208871.2, February 9, 1989.

[30] E.g., OMB Circular No. A-87, para. E. 1.

[31] GAO, A Glossary of Terms Used in the Federal Budget Process, PAD-81-27, at 87 (1981).

Allowable costs are determined on the basis of the relevant program legislation, regulations, including OMB directives, and the terms of the grant agreement. First and foremost, of course, is the program statute. Thus, where the legislation and legislative history of a program clearly limited the purposes for which grant funds could be used, grantees could not use grant funds for non-specified purposes, including one for which Congress had provided funds under a separate appropriation. 35 Comp. Gen. 198 (1955). In 55 Comp. Gen. 652 (1976), however, a statute prohibiting certain costs was held to apply only to direct costs and, absent legislative history to the contrary, did not preclude use of standard indirect cost rates even though technically a percentage of the indirect cost rates could be attributed to the prohibited items.

The role of agency regulations is illustrated by California. United States, 547 F.2d 1388 (9th Cir. 1977), cert. denied, 434 U.S. 824. Under the Federal-Aid Highway Act, the United States pays 90 percent of the "total cost" of certain highway construction, with "cost" being defined to include the cost of right-of-way acquisition. The Federal Highway Administration had issued a policy memorandum stating that program funds would not be used to pay interest on any portion of a condemnation award or settlement for more than 30 days after the money is deposited with the court. California challenged the restriction. The court said:

"Certainly, Congress must have intended that the statutory obligation to pay 90 percent of the total cost must include some corresponding right to impose reasonable limitations upon such costs, rather than to leave the Federal Treasury at the mercy of unfettered discretion by the State as to what expenditures may be made and charged accordingly."

Id. at 1390. The court saw no need to decide whether the policy memorandum rose to the level of a "regulation." Either way, it was a reasonable exercise of the agency's authority to administer the program. See also Louisiana Department of Highways v. United States, 604 F.2d 1339 (Ct. Cl. 1979) (Federal Highway Administration regulation disallowing costs of grantee settlements of worthless claims).

Several GAO decisions illustrate the significance of the grant agreement. For example, where a grant application specified that certain costs would be incurred and the program legislation was ambiguous as to whether those costs should be allowed, the grantor

agency was held bound by the grant agreement, i.e., by its acceptance of the application. B-1 18638.101, October 29, 1979.

The familiar cost overrun is not the exclusive province of the government contractor. Assistance recipients may also incur overruns. A claim resulting from an overrun under a cooperative agreement was denied in B-206272.5, March 26, 1985, because, under the agreement, the agency was not obligated to fund overruns unless it chose to amend the agreement and, in its discretion, it had declined to do so. Cf. B-209649, December 23, 1983 (labor benefits awarded by court to employees of grantee's contractor could be regarded as indirect costs under grant terms, as long as applicable ceiling on indirect costs was not exceeded).

GAO is occasionally asked to review allowable cost determinations. Two examples are-Nuclear Waste: DOE Needs to Ensure Nevada's Conformance With Grant Requirements, GAO/RCED-90-1 73 (July 1990), and Job Training Partnership Act: Review of Audit Findings Related to the Downriver Community Conference Program, GAO/HRD-90-105 (May 1990). The analytical framework employed is that outlined above.

b. Grant Cost Cases

Grant cost cases are extremely difficult to categorize because what is allowable under one assistance program may not be allowable under another. Accordingly, summaries of a number of cases are given below with no further attempt to generalize.

Recovery of antitrust damages by a state grantee stemming from a grant-financed project serves to reduce the actual costs of the grantee and must be accounted for to the government. This is true even where the United States has declined to participate in the cost of the antitrust action. 57 Comp. Gen. 577 (1978). However, the government is not entitled to share in treble damages. 47 Comp. Gen. 309 (1967). Out-of-pocket expenses incurred by the state in effecting the recovery should be shared by the federal government in the same proportion as the recovered damages. B-162539, October 11, 1967.

Where a grantee paid a nondiscriminatory sales tax on otherwise proper expenditures with grant funds, the taxes are not taxes imposed on the United States and are allowable. 37 Comp. Gen. 85 (1957). However, property taxes were held not allowable under a construction

grant because they represent operating costs rather than construction costs, B-166506, February 14, 1973.

The payment of expert witness fees was found unrelated to the purposes of a research grant. 42 Comp. Gen. 682 (1963).

Construction of a bridge could not be paid for out of federal aid highway funds where the construction was necessitated by a flood control project and not as a highway project. 41 Comp. Gen. 606 (1962).

Buses acquired by a city under a "mass transportation" grant could be used for charter service, an unauthorized grant purpose, where such use was merely incidental to the primary use of the buses for authorized mass transit purposes. B-160204, December 7, 1966.

The salary of an individual hired to evaluate the Upward Bound Program at a grantee college was disallowed as a grant cost, because the grant document contained no provision for such an expenditure and the applicable program guidelines specified that evaluation was not an allowable expense. B-161980, November 23, 1971.

The cost of a luncheon for top officials of the Department of Human Resources, District of Columbia Government, was disallowed as an improper administrative expense under a social services program grant under Title XX of the Social Security Act. B-187150, October 14, 1976.

Ordinarily, increased project costs resulting from grantee negligence giving rise to justified claims for damages would not be allowable. However, a damage award was viewed as a recognizable cost element where the grantee's error had contributed to an unrealistically low initial cost, but an amendment to the grant was required before the increased costs could be allowed. 47 Comp. Gen. 756 (1968).

Under a Federal Airport Act program providing for federal payment of a specified percentage of allowable project costs, the fair value of land and equipment donated to the grantee could be treated as an allowable cost because failure to do so would, in effect, penalize the grantee for the contributions of "public spirited citizens." B-81321, November 19, 1948.

Litigation costs incurred by grantees in suing the United States were found unallowable under the Nuclear Waste Policy Act of 1982. Nevada v. Herrington, 827 F.2d 1394 (9th Cir. 1987).

c. Note on Accounting

Cost principles on which a grant award is conditioned are binding on the grantee. B-203681, September 27, 1982. It is the grantee's responsibility to maintain adequate fiscal records to support the allowable costs claimed. With respect to state and local governments, see generally Common Rule §___.20,53 Fed. Reg. 8090. Where a grantee has not kept adequate records, evidence of satisfactory progress on the grant may nevertheless justify a limited "presumption of regularity" since by inference the grantee must have incurred some allowable expenses. However, it does not follow that all expenses claimed should be allowed. Where a particular accounted-for time period includes disallowed costs, similar disallowable costs must be projected as present during prior unaccounted-for periods unless there is proof to the contrary, the presumption being that similar errors occurred during the prior periods. B-186166, August 26, 1976. Although the agency has discretion to determine the precise method of calculation, one approach is to disallow the same proportion of funds for the unaccounted-for periods as were disallowed for the period for which accounts were available. Id.

GAO has questioned the assessment of fiscal sanctions by a grantor agency against a grantee on the basis of error rate statistical data, such as errors imputed from a quality control system. See B-194548, July 10, 1979. In Georgia v. Califano, 446 F. Supp. 404, 409–10 (N.D. Ga. 1977), however, the court upheld the determination of overpayments under the Medicaid program on the basis of statistical sampling, in view of the "practical impossibility" of individual claim-by-claim audit. The court also noted that, under the pertinent federal regulations, the state was given the opportunity to present evidence before the disallowance became final.

In Maryland v. Mathews, 415 F. Supp. 1206 (D.D.C. 1976), a case involving the Aid to Families with Dependent Children program, the court held that an agency can establish by regulation a withholding of federal financial participation in a specified amount set by a tolerance level, as long as the tolerance level is reasonable and supported by an adequate factual basis. The regulation involved in the specific case, however, did not meet the test and was found to be arbitrary and therefore invalid. It has also been held that, if setting a tolerance level

is discretionary, the agency can set it at zero. Maryland Department of Human Resources v. Department of Health and Human Services, 762 F.2d 406 (4th Cir. 1985); California. Settle, 708 F.2d 1380 (9th Cir. 1983).

2. Pre-Award Costs (Retroactive Funding)

"Retroactive funding" means the funding of costs incurred by a grantee before the grant was awarded. Three separate situations arise: (1) costs incurred prior to award but after the program authority has been enacted and the appropriation became available; (2) costs incurred prior to award and after program authority was enacted but before the appropriation became available; and (3) costs incurred prior to both program authority and appropriation availability.

Situation (l): In this situation, the grantee seeks to charge costs incurred before the grant was awarded (in some cases even before the grantee submitted its application) but after both the program legislation and the implementing appropriation were enacted.

There is no rule or policy that generally restricts allowable costs to those incurred after the award of a grant. However, agencies may adopt such a policy by regulation. B-197699, June 3, 1980.

Thus, in a number of cases, grant-related costs incurred prior to award, but after the program was authorized and appropriated funds were available for obligation, have been allowed where (a) there was no contrary indication in the language or legislative history of the program statute or the appropriation, (b) allowance was not prohibited by the regulations of the grantor agency, and (c) the agency determined that allowance would be in the best interest of carrying out the statutory purpose. 32 Comp. Gen. 141 (1952); 31 Comp. Gen. 308 (1952); B-197699, June 3, 1980; B-133001, March 9, 1979; B-75414, May 7, 1948. (The above criteria are not specified as such in any of the cases cited but are derived from viewing all of the cases as a whole.)

Situation (2): In this situation, pre-award costs are incurred after program legislation has been enacted, but before an appropriation becomes available.

Prior to the Comptroller General's decision in 56 Comp. Gen. 31 (1976), a "general rule" was commonly stated to the effect that

absent some indication of contrary intent, an appropriation could not be used to pay grant costs where the grantee's obligation arose before the appropriation implementing the enabling legislation became available. 45 Comp. Gen. 515 (1966); 40 Comp. Gen. 615 (1961); 31 Comp. Gen. 308 (1952); A-71315, February 28, 1936.

In 56 Comp. Gen. 31, the Comptroller General reviewed the earlier decisions and concluded that there was no legal requirement for a general rule prohibiting the use of grant funds to pay for costs incurred prior to the availability of the applicable appropriation. Rather, the determination should be made on a case-by-case basis. Thus, the decision announced:

"We would prefer to base each decision from now on on the statutory language, legislative history, and particular factors operative in the particular case in question, rather than on a general rule." Id. at 35.

In reviewing the earlier decisions, the Comptroller General found that each had been correctly decided on its own facts. Thus, retroactive funding was prohibited in 40 Comp. Gen. 615 (1961), 31 Comp. Gen. 308 (1952), and A-71315, February 28, 1936. However, in each of those cases, there was some manifestation of an affirmative intent that funds be used only for costs incurred subsequent to the appropriation. For example, 31 Comp. Gen. 308 concerned grants to states under the Federal Civil Defense Act. The committee reports and debates on a supplemental appropriation to fund the program contained strong indications that Congress did not intend that the money be used to retroactively fund expenses incurred by states prior to the appropriation. By way of contrast, there were no such indications in the situation considered in 56 Comp. Gen. 31 (matching funds provided to states under the Land and Water Conservation Fund Act of 1965). Accordingly, 56 Comp. Gen. 31 did not overrule the earlier decisions, but merely modified them to the extent that GAO would no longer purport to apply a "general rule" in this area.

In determining whether retroactive funding is authorized, relevant factors are evidence and clarity of congressional intent, the degree of discretion given the grantor agency, and the proximity in time of the cost being incurred to the grant award. As in Situation (l), significant factors also include the agency's own regulations and the agency's determination that funding the particular costs in question will further the statutory purpose. Accordingly, the authority will be easier to find where an agency has broad discretion and favorable legislative

history. Using this approach, retroactive funding authority maybe found to exist (as in 56 Comp. Gen. 31), or not to exist (as in 40 Comp. Gen. 615).

If an agency wishes to recognize retroactive funding in limited situations in its regulations, it must, in order to avoid potential Antideficiency Act problems, make it clear that no obligation on the part of the government can arise prior to the availability of an appropriation. Of course, the grant itself cannot be made until the appropriation becomes available. 56 Comp. Gen. 31, 36 (1976).

Situation (3): In this situation, the grantee seeks to charge costs incurred not only before the appropriation became available, but also before the program authority was enacted.

Costs incurred prior to both the program authorization and the availability of the appropriation may generally not be funded retroactively. See 56 Comp. Gen. 31 (1976); 32 Comp. Gen. 141 (1952); B-11393, July 25, 1940. GAO recognizes that there may possibly be exceptions even to this rule (56 Comp. Gen. at 35), but thus far there are no decisions identifying any.

One final situation deserves mention. In each of the retroactive funding cases cited above, the grant was in fact subsequently awarded. In B-206244, June 8, 1982, a state had applied for an Interior Department grant under the Youth Conservation Corps Act and later withdrew its application due to funding uncertainties. The state then filed a claim for various expenses it had incurred in anticipation of the grant. GAO held that payment would violate both the program legislation and the purpose statute, 31 U.S.C. § 1301(a). Interior's appropriation was intended to accomplish grant purposes, but the state's expenses did not accomplish any grant purposes since the grant was never made.

H. Recovery of Grantee Indebtedness

1. Government's Duty to Recover

This section is intended to summarize the application of "debt collection law" (covered in detail in Chapter 13) in the context of assistance programs, and to highlight a few issues in which the fact that a grant is involved maybe of special relevance. This brief discussion is intended to supplement the detailed coverage in Chapter 13; it is not a substitute.

Claims in favor of the United States against an assistance recipient may arise for a variety of reasons. As a general proposition, it has been the view of both GAO and the executive branch that the United States has not only a right but a duty to recover amounts owed to it, and that this duty exists without the need for specific statutory authority. This applies to assistance recipients just as it would apply to other debtors. The Federal Claims Collection Standards require each agency to "take aggressive action. . . to collect all claims of the United States for money or property arising out of the activities of, or referred to, that agency." 4 C.F.R. § 102. l(a). See also Common Rule §___.52,53 Fed. Reg. 8102.

For example, grant funds erroneously awarded to an ineligible grantee must be recovered by the agency responsible for the error, including expenditures the grantee incurred before receiving notice that the agency's initial determination had been made in error. 51 Comp. Gen. 162 (1971); B-146285/B-164031(1), April 19, 1972. The cited decisions recognize that there might be exceptional circumstances in which full recovery might not be required, but exceptions would have to be considered on an individual basis.

Similarly, where an agency misapportions formula grant funds so that some states receive excess funds, the excess must be recovered. If the misapportionment resulted in other states receiving less than their formula amount, the apportionments of all of the states involved must be appropriately adjusted. 41 Comp. Gen. 16 (1961).

Where, under an assistance program, the government is authorized or required to recover funds for whatever reason, the Federal Claims Collection Act of 1966, as amended by the Debt Collection Act of 1982 (31 U.S.C. Chapter 37, Subchapter II), and the joint GAO-Justice

Department implementing regulations (Federal Claims Collection Standards, 4 C.F.R. Parts 101– 105) apply unless the program legislation under which the claim arises or some other statute provides otherwise. See 4 C.F.R. § 101.4; B-163922, February 10, 1978; B-182423, November 25, 1974.

Indebtedness to the United States may also result from the misuse of grant funds. E.g., Utah State Board for Vocational Education v. United States, 287 F.2d 713 (10th Cir. 1961); Mass Transit Grants: Noncompliance and Misspent Funds by Two Grantees in UMTA's New York Region, GAO/RCED-92-38 (January 1992). The cases usually arise when the grantor agency disallows certain costs. Here again the government's position has been that the right to recover exists independent of statute, supplemented or circumscribed by any statutory provisions that may apply. See, e.g., B-198493, July 7, 1980; B-163922, February 10, 1978. In this area, however, the government's right to recover has come under increasing attack by recipients, particularly during the 1980s.

What we present here is by no means an exhaustive cataloging of the cases. Our selection is designed to serve three purposes: (1) summarize what the law appears to be as of the date of this publication; (2) reflect any discernible trends; and (3) point out some issues that may be of more general relevance. As a general proposition, the courts have looked first to the program legislation and, with some exceptions, have declined to rule on the government's common-law right of recovery where adequate authority could be found in, or deduced from, the enabling statute.

The cases we selected for purposes of illustration are drawn largely from two programs–Title I of the Elementary and Secondary Education Act (ESEA), and the Comprehensive Employment and Training Act (CETA). ESEA was extensively revised by the Hawkins-Stafford Elementary and Secondary School Improvement Amendments of 1988 (Pub. L. No. 100-297, 102 Stat. 130); CETA was replaced in 1982 by the Job Training Partnership Act. Nevertheless, we chose these programs because they both generated a large volume of litigation on a variety of relevant topics. Apart from whatever value specific cases may have by analogy to other programs, the material illustrates the kinds of issues that have arisen and the approach the courts, including the Supreme Court, have taken in resolving them.

ESEA included a provision, very common in grant program legislation, requiring the states to provide adequate assurances to the Department of Education that grant funds would be used only on qualifying programs. In addition, the law was amended in 1978 to give the Secretary of Education explicit authority to direct the repayment of misspent grant funds from non-ESEA sources. 20 U.S.C. § 2835(b) (1982). Prior to this amendment, the statute had provided simply that payments under Title I shall take into account the extent to which any previous payment to the same state was greater or less than it should have been.

Two states argued that the 1978 amendments did not apply to misspent funds prior to 1978, and that the government's sole remedy with respect to pre-1978 funds was to withhold future grant funds, in which event the state would simply undertake a smaller Title I program. The government argued that the right to recover existed both under the pre-1978 law and under the common law. The Supreme Court held that the pre-1978 version of the law clearly gave the government the right to recover misspent funds. Bell v. New Jersey, 461 U.S. 773 (1983). Apart from the holding itself and its significance with respect to any program statutes with similar language, several other points from this decision are noteworthy:

- The existence and amount of the state's debt are to be determined administratively by the agency in the first instance, subject to judicial review. Id. at 791–92. (This is the same approach used in the Federal Claims Collection Standards for debt collection generally.)
- The Court rejected the argument that the government had a remedy by withholding future funds, with the state correspondingly reducing its program level.
- Because the Court found adequate authority in the statute, it declined to rule on the existence of a common-law right. Id. at 782 n.7.

In a 1981 case, a lower court had found a common-law right of recovery along with the ESEA statutory right. West Virginia v. Secretary of Education, 667 F.2d 417 (4th Cir. 1981). A 1987 case also upheld the government's common-law right of recovery, at least to the extent of overallocations or other erroneous payments. California Department of Education v. Bennett, 829 F.2d 795,798 (9th Cir. 1987).

Two years after Bell v. New Jersey, the Supreme Court considered another issue arising from the same litigation and held that the 1978 amendments to ESEA were not retroactive for purposes of determining whether funds had been misspent. Bennett v. New Jersey, 470 U.S. 632 (1985). What is important here is the more general rule the Court announced, namely, that substantive rights and obligations under federal grant programs are to be determined by reference to the law in effect when the grants were made. Id. at 638–41.

The Court also rejected an argument that recovery would be inequitable because the state acted in good faith. The role of the reviewing court is to determine if the proper legal standards are applied. If they are, a court has "no independent authority to excuse repayment based on its view of what would be the most equitable outcome." Id. at 646. In any event, said the Court, "we find no inequity in requiring repayment of funds that were spent contrary to assurances provided by the State in obtaining the grants." Id. at 645.

In Bennett v. Kentucky Department of Education, 470 U.S. 656 (1985), decided on the same day as Bennett v. New Jersey, the Court reaffirmed the government's right of recovery under ESEA Title I:

"The State gave certain assurances as a condition for receiving the federal funds, and if those assurances were not complied with, the Federal Government is entitled to recover amounts spent contrary to the terms of the grant agreement." 470 U.S. at 663.

The Court further-concluded that neither "substantial compliance" by the state nor the absence of bad faith would absolve the state from its liability. Id. at 663–65. See also B-229068-O. M., December 23, 1987, applying Kentucky to grants under Title V of the Surface Mining Control and Reclamation Act.

One point in Bell v. New Jersey seems to have generated some uncertainty. The Court noted that the Secretary "has not asked us to decide what means of collection are available to him, but only whether he is a creditor. Since the case does not present the issue of available remedies, we do not address it." Bell, 461 U.S. at 779 n.4. Thus, the Court did not approve or disapprove of arty particular remedy. This led one court to conclude that the Bell analysis requires two separate questions: whether the federal government has a right of recovery and, if so, what remedies are available to it. Maryland Department of

Human Resources v. Department of Health and Human Services, 763 F.2d 1441, 1455 (D.C. Cir. 1985) (holding that government has statutory right of recovery under Title XX of Social Security Act). However, another court expressed doubt over the existence of such a dichotomy, construing the Supreme Court's silence in Bennett v. Kentucky Department of Education as approval of the means of recovery employed in that case, a direct repayment order. St. Regis Mohawk Tribe v. Brock, 769 F.2d 37,49 (2d Cir. 1985), cert. denied, 476 US. 1140 (right of recovery under Comprehensive Employment and Training Act). The St. Regis court went on to conclude that "Congress left it to the Secretary to establish additional remedial procedures, consistent with the purposes of the legislation, to insure compliance by prime sponsors." 769 F.2d at 50. Where this issue may lead in the future is unclear, although as noted briefly later in this chapter and discussed more fully in Chapter 13, the availability of a particular remedy sometimes is a very different question from the existence of the underlying right to recover.

Another group of cases involves the former CETA program There is a strong parallel to the ESEA cases in that the original CETA included general authority to adjust payments to reflect prior overpayments or underpayments, and was amended in 1978 to explicitly authorize the Secretary of Labor to recover misspent funds by ordering repayment from non-CETA funds. Essentially following Bell v. New Jersey, a rather long line of cases upheld the Labor Department's right, under the pre-1978 CETA, to recover misspent funds and to do so by directing repayment from non-CETA funds. City of Gary v. United States Department of Labor, 793 F.2d 873 (7th Cir. 1986); St. Regis Mohawk Tribe v. Brock, 769 F.2d 37 (2d Cir. 1985), cert. denied, 476 U.S. 1140; Mobile Consortium. United States Department of Labor, 745 F.2d 1416(1 1th Cir. 1984); California Tribal Chairman's Association v. United States Department of Labor, 730 F.2d 1289 (9th Cir. 1984); North Carolina Commission of Indian Affairs v. United States Department of Labor, 725 F.2d 238 (4th Cir. 1984), cert. denied, 469 U.S. 828; Texarcana Metropolitan Area Manpower Consortium v. Donovan, 721 F.2d 1162 (8th Cir. 1983); Lehigh Valley Manpower Program v. Donovan, 718 F.2d 99 (3d Cir. 1983); Atlantic County v. United States Department of Labor, 715 F.2d 834 (3d Cir. 1983).

The St. Regis (769 F.2d at 47), California Tribal (730 F.2d at 1292), and North Carolina (725 F.2d at 240) courts, as had the Supreme

Court in Bell v. New Jersey, declined to comment on the existence of a common-law right of recovery. The Texarcana court noted that its decision was consistent with prior decisions recognizing the common-law right. 721 F.2d at 1164. None of the cases purported to deny that right.

Another group of CETA cases concerned a provision which required the Secretary of Labor to investigate any complaint alleging improprieties and to issue a final determination not later than 120 days after receiving the complaint. The consequences of failing to meet the 120-day deadline became a hotly litigated issue. The lower courts split, some holding that failure to meet the deadline barred the Labor Department from attempting to recover misused funds, while others held that the failure did not bar further action. Using an analysis which should be useful in a variety of situations, the Supreme Court resolved the conflict in Brock v. Pierce County, 476 U.S. 253 (1986), holding that the mere use of the word "shall" in the statute did not remove the power to act after 120 days.

One additional CETA case deserves mention. In Board of County Commissioners v. United States Department of Labor, 805 F.2d 366 (10th Cir. 1986), the court held that funds embezzled by an employee of a CETA grantee are "misspent" for purposes of the government's right of recovery. The grantee had argued that the funds were not "misspent" because it had never spent them. "No CETA regulation lists embezzlement as an allowable cost," rejoined the court. Id. at 368.

Where does all this leave us? Certainly the government's right to recover under programs with statutory provisions similar to the former ESEA Title I and CETA programs would seem to be settled. In more general terms, several lower courts have recognized the government's basic right to recover under the common-law," although as we shall see, the means of recovery has become controversial. While the Supreme Court declined to address the common law issue in Bell v. New Jersey, its later decision in West Virginia v. United States, 479 U.S. 305 (1987) seems instructive.

[32] *See*, in addition t. the cases cited in the text, Tennessee v. Dole cases v. Dole, 749 F.2d 331, 336 (6th Cir. 1984), cert. denied, 472 U.S. 1018 (Federal-Aid Highway Act); Woods v. United States, 724 F.2d 1444 (9th Cir. 1984) (Food Stamp Act); Mount Sinai Hosp. v. Weinberger, 517 F.2d 329 (5th Cir. 1975), cert. denied, 425 U.S. 935 (Medicare); Pennsylvania Dep't of Transp. v. United States, 643 F.2d 758,764 (Ct. Cl. 1981), cert. denied, 454 U.S. 826 (Federal-Aid Highway Act).

The issue in West Virginia was whether the United States could recover "prejudgment interest on a debt arising from a contractual obligation to reimburse the United States for services rendered by the Army Corps of Engineers." 479 U.S. at 306. Applying federal common law, a unanimous Court held that it could.[33] While this was not a grant case nor was the government's right to collect the underlying debt in dispute, it would not seem to require a huge leap in logic to infer a recognition of art inherent right in the government to recover amounts owed to it.

In sum, the government's assertion of an inherent (i.e., common law) right to recover sums owed to it under assistance programs thus far seems to have withstood assault. However, it is safe to say that the question is by no means as simple as it once might have seemed.

2. Offset and Withholding of Claims Under Grants

Offset and withholding are two closely related remedies. While the terms are sometimes used interchangeably, they are not the same. Offset, in the context of grantee indebtedness, refers to a reduction in grant payments to a grantee who is indebted to the United States where the debt arises under a separate assistance program or is owed to an agency other than the grantor agency. Withholding is the act of holding back funds from the same grant or program in which the violation or other basis for creating the government's claim occurred. In a sense, withholding maybe viewed as a type of offset.

GAO has adopted a "policy rule" that offset or withholding should not be used where it would have the effect of defeating or frustrating the purposes of the grant. E.g., B-171019, December 14, 1976; B-186166, August 26, 1976. The application of this rule depends upon the nature and purpose of the assistance program. "Individual consideration must be given to each instance." B-182423, November 25, 1974. Naturally, this consideration must include any relevant provisions of the program legislation, agency regulations, or the grant agreement.

In 43 Comp. Gen. 183 (1963), for example, a farmer who was receiving payments under the Soil Bank Act, administered by the

[33] Complications resulting from the Debt Collection Act of 1982, discussed in Chapter 13, did not apply in this case because the transaction predated the effective date of that statute. West Virginia, 479 U.S. at 312 n.6.

Department of Agriculture, was indebted to the United States for unpaid taxes. Since the basic purpose of the Soil Bank Act was to protect and increase farm income, GAO decided that whether those payments should be applied to the recovery of an independently arising debt was a matter within Agriculture's discretion, based on Agriculture's determination "as to the extent to which such withholding would tend to effectuate or defeat the purposes of the [Soil Bank Act]." Id. at 185. Similarly, relying heavily on the Treasury Department's interpretation of the State and Local Fiscal Assistance Act of 1972 (general revenue sharing, since repealed), GAO concluded in B-176781 -O. M., December 6, 1974, that offset against revenue sharing funds payable to a city was inappropriate to recover an overpayment to that city under a Federal Aviation Administration grant. Thus, agencies have some discretion in the matter.

It has been somewhat easier to conclude that offset will frustrate grant objectives where grant payments are made in advance of grantee performance. E.g., 55 Comp. Gen. 1329 (1976); B-171019, December 14, 1976. This is true to the extent the grantee is able to reduce its level of performance. Take, for example, a grant to construct a hospital. If a debt is offset against grant advances and the grantee can simply forgo the project and not build the hospital, there is no meaningful recovery. The federal government ends up keeping its own money, the grantee pays nothing, and the losers are the intended beneficiaries of the assistance, the patients who would have used the hospital. To this extent, an offset would accomplish nothing. This was the explicit grounds for rejecting offset, for example, in B-171019, December 14, 1976.

The problem was highlighted in a 1982 GAO report, Federal Agencies Negligent in Collecting Debts Arising From Audits, AFMD-82-32 (January 22, 1982). The report first noted GAO's policy and its rationale:

"[I]t is normally inappropriate for the Government to offset debts against an advance of funds to a grantee unless there is assurance that the same level of grant performance will be maintained.

"... When the offset is not replaced with non-Federal funds, there has, in effect, been no repayment. The scope of the program has simply been reduced and the intended recipient of the benefits loses by the amount of the audit disallowance."

Id. at 26. The report then recommended that grantor agencies "require grantee debtors to certify that their payment of audit-related debts has not reduced the level of performance of any Federal program," and monitor those assurances through grant management and audit follow-up. Id. at 28.

The concept also appeared in B-186166, August 26, 1976, in which the Department of Agriculture was exploring options to recover misapplied and unaccounted-for funds advanced to a university under research grants. Agriculture proposed crediting the indebtedness against allowable indirect grant costs. This would be done by requiring the university to document that it was expending the amount of earned indirect costs on approved program grants, thus maintaining the agreed-upon performance level. GAO concurred cautiously, on the condition that the grantee voluntarily agree to this approach. Should this method fail to satisfy the indebtedness, GAO further noted that the grantee was a state university and advised Agriculture to seek offset against other amounts owed to the state by the federal government.

A solution to the problem would be a rule that offset or withholding implicitly carries with it an obligation that the grantee not reduce its level of performance. As demonstrated by GAO's caution in B-186166, however, GAO has been reluctant to state such a rule in the absence of solid judicial precedent. As discussed later, this precedent may now exist, at least to some extent.

Whatever impediments may exist in the case of grant advances, offset will be more readily available under reimbursement-type grants. E.g., 55 Comp. Gen. 1329, 1332 (1976). Nevertheless, the general policy rule still applies. Thus, in B-163922.53, April 30, 1979, the Comptroller General advised the Departments of Labor and Transportation that disallowed costs under a Labor Department grant could be offset against reimbursements due under a Federal Highway Administration grant, but that Transportation still "must make the determination on a case-by-case basis as to whether offset will impair the program objectives."

When the GAO decisions cited in the preceding paragraphs were issued, the offset referred to was essentially nonstatutory. Administrative offset received a statutory basis with the enactment of section 10 of the Debt Collection Act of 1982, 31 U.S.C. $3716. The

corresponding portion of the Federal Claims Collection Standards, revised to reflect the 1982 legislation, is 4 C.F.R. $102.3.

The administrative offset provided by 31 U.S.C. § 3716 does not apply to debts owed by state and local governments. 31 U.S.C. § 3701(c). Whether common-law offset remains against state and local governments has become a highly controversial issue. The position of GAO and the executive branch is that the government's common-law right of offset has not been abrogated with respect to state and local governments. See 4 C.F.R. §102.3(b)(4); Common Rule §___.52(a)(1), 53 Fed. Reg. 8103. The issue is explored more fully in Chapter 13.

As noted above, offset and withholding are technically different. Many program statutes include withholding provisions. E.g., Perales v. Heckler, 762 F.2d 226 (2d Cir. 1985) (withholding provision in Medicaid legislation may be used to recoup overpayments from state even though state has not yet recovered from provider).

The theory behind withholding is that where a grantee has misapplied grant funds, or in other words, where a grantee's costs are disallowed, the grantee has, in effect, spent its own money and not funds from the grant. Since the issue frequently comes to light in a subsequent budget period, withholding may be viewed as the determination that an amount equal to the disallowed cost remains available for expenditure by the grantee and is therefore carried over into the new budget period. Accordingly, the amount of new money that must be awarded to the grantee to carry on the grant program is reduced by the amount of the disallowance. This may not be strictly applicable where the statutory program authority establishes an entitlement to the funds on the part of the grantee or provides other specific limitations on the use of withholding.

Under the Federal Claims Collection Standards, an agency to whom a debt is owed is required in all cases to explore the possibility of collecting by offset from other sources. 4 C.F.R. § 102.3(a). If offset is not available, a withholding provision may provide the basis to accomplish a similar result, at least in part. In 55 Comp. Gen. 1329 (1976), for example, the former Community Services Administration was statutorily authorized to suspend (withhold) grant payments to satisfy certain grantee tax delinquencies. Under this authority, the CSA could pay the suspended amounts over to the Internal Revenue

Service to satisfy a grantee's tax liability to the extent that it was incurred by the grantee in carrying out CSA grants. Since funds previously advanced under the grant should have been used to pay the required taxes in the first place, transfer of the suspended funds to the IRS amounted to payment of an authorized grant purpose. See also B-171019, December 14, 1976 (withholding authority of former Law Enforcement Assistance Administration).

In any event, withholding under a limited statutory withholding provision does not satisfy the requirement for the agency to seek offset from other sources to the extent of any remaining liability for which withholding is not available. B-163922, February 10, 1978.

Statutory withholding provisions may include procedural safeguards, most typically notice and opportunity for hearing. Any such procedural requirements must, of course, be satisfied. See B-226544, March 24, 1987; Common Rule § ___.43(b), 53 Fed. Reg. 8102. The Common Rule authorizes withholding against advances, but cautions agencies to use sound judgment in exercising that authority. Common Rule § ___.52(a)(2), 53 Fed. Reg. 8103; Supplementary Information statement, id. at 8042.

As with offset, it should be kept in mind that nothing is accomplished by withholding unless the grantee carries out its program at the same level as would otherwise have been the case. The Supreme Court considered this issue in Bell v. New Jersey, 461 U.S. 773 (1983), upholding the statutory authority of the Department of Education to recover misspent grant funds. The Court rejected the state's suggestion that the federal government was free to reduce future grant advances, with the state then undertaking a smaller program. The Court recognized that, under this approach, the government would recover nothing and the states would effectively have no liability for misspent funds. Congress, said the Court, must have contemplated that the government would receive a net recovery by paying less for the same program level. Id. at 781 n.5 and 783 n.8.

A 1985 decision of the Court of Appeals for the District of Columbia Circuit took the analysis one step further. The case is Maryland Department of Human Resources v. Department of Health and Human Services, 763 F.2d 1441 (D.C. Cir. 1985). After discussing the Bell analysis, the court went on to conclude:

"[W]here a statute gives the federal government a right of recovery and also authorizes prospective withholding [withholding funds for services not yet rendered] as a remedy, the state remains obligated to provide all the services that it promised to supply in return for the funds that were then prospectively withheld in satisfaction of the state's debt to the federal government. If a state then proceeds to *reduce the size* of its federally funded program, the state has committed a new and independent breach of the funding conditions, which gives rise to a new debt to the federal government." 763 F.2d at 1455-56.

Under this approach, the remedy is clearly a meaningful one. How far the courts will go in applying it remains to be seen. Issues still to be resolved are the extent to which the principle may apply to an offset as opposed to a withholding, or to a nonstatutory offset or withholding.

In Housing Authority of the County of King v. Pierce, 701 F. Supp. 844 (D.D.C. 1988), modified on other grounds, 711 F. Supp. 19 (D.D.C. 1989), the court considered the recoupment of overpayments under advance-funded Department of Housing and Urban Development housing subsidies. HUD regulations (but not the program statute) authorized recoupment by reducing future subsidy payments. The court upheld HUD's common-law right to recover in the manner specified in the regulations. The court further commented that the teachings of Bell and Maryland Department of Human Resources "might and perhaps should guide HUD in the course of the recovery here," but found those cases not dispositive because they dealt with statutory rather than common-law remedies. 701 F. Supp. at 850 n. 11.

Thus, there is a direct relationship between the appropriateness of offset or withholding against grant advances and the grantee's obligation to maintain the agreed-upon program level. Future litigation or legislation will determine the details of this relationship.